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Failures in the prudential regulation of banks in the UK and US: will the lessons be learnt?

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The prudential regulation of banking is now undertaken by the Prudential Regulation Authority (PRA) within the Bank of England. Previously, such regulation was undertaken by the Financial Services Authority (FSA). It will be the role of the FSA as the previous regulator in the UK that will be considered. This article will examine the lack of understanding on the part of the FSA about the risk to which banks were subject. Insights into the approach and effectiveness of the FSA can be found in an examination of the reports of various parliamentary committees and the evidence of senior officials, employees and management called to give evidence. These committees have investigated various banking collapses and important issues relating to the carrying on of banking business. The reports and evidence of such committees are a reliable and detailed source of information. These reports are evaluated throughout. It will be suggested that the economic position of such banks does have an effect upon their regulation. Analogous reports in the US will be compared and contrasted with the findings in the UK. Changes in regulation, and its enforcement, after the setting up of the PRA will be considered.

International Banking and Finance

A. Introduction

The collapse of various banking institutions in both the UK and the US, and the reasons for this, have been fully canvassed worldwide in newspapers and economic journals. The fallout from this, and concerns about these collapses has led Parliament to take a keen interest in banking and financial matters such as the protection of depositors, banking collapses and the day-to-day prudential regulation of banking and financial institutions. Further, Parliament has wanted the regulatory institutions to account to it, including senior officials and employees working within such institutions.

Parliament has demonstrated this by being active in calling officials and employees from both the Bank of England (then in its role as macro-economic regulator) and the Financial Services Authority (FSA) (then in its role as the prudential regulator for financial and banking activities) to give evidence before it. There is now a collection of reports with actual real evidence and questioning by parliamentary committee. These parliamentary reports have gone largely unexplored and in a general sense merit academic scrutiny. The views of Parliament and the various experts called to give evidence will be used in this article. They are a reliable and consistent source of material that is crucial and relevant to demonstrate the proposition contended above. Some of these parliamentary reports are investigations at a general level whilst others are very specific or about particular case situations. The focus will be on those parts of those parliamentary reports that make comment about the regulators, in particular the FSA.

B. Importance and use of parliamentary reports

The institutions and the general banking matters that will be considered are those that have been subject to parliamentary scrutiny. They are matters that are important or topical in the eye of Parliament rather than a specific set of decisions determined in a logical way. They will be considered in chronological order, or alternatively, in a way which highlights important points about failure of regulation on the part of the FSA and to attempt to support the proposition that self-regulation leads to poor regulation.¹

The rules governing the system of regulation in England have consistently not allowed the regulator to be sued unless there is fraud or misfeasance.² This has the consequence that there has not been any case law or developing case law on the negligence on the part of the English regulatory system.³ Such jurisprudence is mainly to be found in the parliamentary reports but with a different dimension. It is not whether a group of investors or depositors have suffered loss caused by regulatory failure, but whether the regulator is at a general level functioning well and serving the public interest. The parliamentary committees, with their examination of officials in senior regulatory positions and also of senior management of banks, provide much information which would otherwise not appear in the public domain.

C. Methodology

Much is happening in banking. The various parliamentary committees tend to be set up as a reaction to the various

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events that occur. The parliamentary website contains many reports on all areas and any search can be narrowed to a search for banking which will indicate the times of recent or imminent parliamentary committees covering banking matters. The various matters affecting banking and the parliamentary committees are covered in the newspapers.⁴ If one searches the online archive centre of the *Financial Times* under Andrew Tyrie, usually chairperson of the various parliamentary committees covering banking, one will see not only the particular reports affecting prudential banking which form the subject matter of this article, but also other matters such as his requests for information or letters to the FSA, which may not feature on the official parliamentary website. Major prudential failures are the subject of press coverage, which are a form of record as to the views about such failure, but also indicate that Parliament will be scrutinising the activities of management. It follows that it is likely to be the case that senior officials or employees of regulatory institutions are also likely to be examined by the relevant parliamentary committee. Sadly there continue to be such failures so that there is the need for various regulatory officials to justify and explain their actions. The parliamentary committees provide not only an account of what has gone wrong but also a detailed account of the failure of management of the relevant bank. The committee will also consider whether there were failings on the part of the regulator, and if so in what way(s). The reports of the newspapers have tended to concentrate on the failings of management, and are a useful way of confirming the views of the parliamentary committee and that there is a consistency of approach and conclusion. Parliament tends to go further, but it is able to do so as it will cross-examine senior officials within the regulatory body responsible for regulating the failed bank. It is important to note that Parliament has the necessary power(s) to examine such witnesses. Further, such witnesses may be asked to provide additional written evidence on relevant matters. This approach is useful if the matter is of a wide-ranging nature and requires further investigation. It is suggested that this will provide for the accuracy of such replies as witnesses can be recalled and failure to provide answers could lead to sanctions comparable with those which could be imposed by the courts. The point is that one is able to say that the evidence of witnesses, normally contained in a separate volume, will be cogent, accurate and reliable. It is a source of information not otherwise readily obtainable. Furthermore, such reports have to date escaped the scrutiny of systematic research. Each report will be described in detail together with any follow-up reports. These reports will then be evaluated.

D. Prudential regulation or self-regulation or meta-regulation

It becomes necessary to explain what is meant by meta-regulation, since this term has been used in academic circles. The term covers any type of regulation but for the purpose of this article it will be confined to banking and financial regulation. Those who have developed this theory have identified two parts to it. The first part is that there is in place a system of "self-regulation" of banks.⁵ It has been suggested by Professor Julia Black that for this system to work, banks must have the strong wish to take on board public needs and not simply be motivated by the wish to maximise profits.⁶ It is this that has been shown to be problematic in that some banks have been motivated only by a desire to maximise profits and not by social considerations. A bank will often wish to underestimate the risks to which it is subject, when lending, so as to maximise profits.⁷

The second part is that the regulator, previously the FSA, and now the Prudential Regulation Authority (the PRA, being responsible for prudential regulation) and the Financial Conduct Authority (FCA) within the Bank of England⁸ are to regulate this self-regulation. The role of the regulators has been criticised in that they have lacked the necessary skill and desire to regulate. It is these failings that are the subject of this article. These factors of skill and desire on the part of regulators have been identified as necessary for meta-regulation to work.⁹ Meta-regulation theory says that there must be sanctions for failure to comply or rewards for those that do comply with the regulatory requirements.¹⁰ The approach of the FSA was that, as there were rules governing risk,¹¹ that was all that was necessary. The approach of the FSA was to assume that the banks were complying with the rules relating to risk. The FSA did not check the substance of matters relating to risk and left the issue of risk as a matter to be determined by the banks and not by the FSA.¹²

There is also a further link between risk and prudential regulation in that traditionally it has been up to the bank to identify and work out the extent of the risk to which it is subject.¹³ In that sense this has been a matter for the bank.¹⁴ The collapses of banking institutions as a consequence of excessive risk taking or incorrect evaluation of the risks to which those institutions were subject feature in the various case situations in this article which are the subject of parliamentary scrutiny. There was over-reliance upon the risk models of the banks by the regulator,¹⁵ and failure of the regulator to assess, independently itself the risks to which various banks were subject. The FSA failed to take proper actions to stop the banks from taking excessive risk. A slight variant on the theme is put forward by Sharon Gilad¹⁶ in an analysis of enforced self-regulation. The point is that the regulator, the FSA, failed to take proper enforcement action and the parliamentary reports considered below expand upon this failure.

In so far as meta-regulation theory assumes or hopes that banks will not wish to maximise profits this has simply just not happened. In particular, the HBOS lending, which will be explored below, was expanded at a rapid rate in order to maximise returns for the bank without paying sufficient attention to the risks that this posed for the bank. With RBS, the bank engaged upon an aggressive strategy of takeover, which over-exposed its capital and liquidity positions and without sufficient recognition of the problems that it would face in the event of an economic downturn. There is also the problem that meta-regulation theory does not feature in any of the reports discussed by Parliament. One wonders about its real value if it not actually used by Parliament to evaluate the work previously carried out by the FSA. There is a more serious structural point -- the separation of academic and practitioner work and the failure of academic analysis to feature in practitioner circles. The matter is, perhaps, better

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classified as a failure of prudential regulation. What is clear is that there need to be rules which must be complied with by banking organisations.¹⁷ Further, that these rules are supervised in the sense of there being supervision, monitoring and enforcement.¹⁸ Some of the major areas of prudential regulation, relevant to the subsequent analysis of the parliamentary reports will be considered below. The failings of the FSA to supervise, monitor and enforce will be discussed and evaluated below.¹⁹

E. Bank capital, liquidity, stress testing and asset quality -- reliance upon internal models by the regulator

1. Capital

Not only is the capital of banks an important issue but it is one which has attracted the attention and scrutiny of Parliament.²⁰ The importance of the maintenance of bank capital and the lack of this during the bank collapses, and financial problems from 2004 onwards has been considered previously by the author of this article.²¹ The regulation of bank capital or perhaps one might say its lack of enforcement is a matter of subsequent regret by governments and regulators.²² For this purpose regulation includes the legislation and regulatory rules governing bank capital.²³ The banking crisis highlighted the lack of attention paid by regulators worldwide in the regulation of bank capital.²⁴ Regulators left it to banks to regulate themselves when it came to capital. The banks ignored the standards that they were expected to adopt. The regulators in the UK took limited action to enforce these capital standards. The approach of the FSA in relation to Basel II and III is considered subsequently.

The Independent Commission on Banking, whose members were called to give evidence before Parliament,²⁵ has wanted higher standards in relation to the capital reserves of banks.²⁶ The PRA is reported to have tested the largest eight lenders through a 3% leverage test in the summer of 2013.²⁷ Professor Julia Black confirms that Basel III is metaregulation but importantly a situation where banks "were allowed to use their own internal risk models to provide the basis for setting their capital requirements".²⁸ She makes the point that this will always be the case, and that regulators will be "reliant"²⁹ on such internal risk models of banks. She regards this as a "fundamental weakness"³⁰ in that such models are designed for the benefit of banks rather than those of the regulator.³¹ The theory of reliance is confirmed in practice.³² Reliance by the regulator was confirmed in relation to Basel III. The regulator will necessarily rely upon the internal models of the bank.

2. Liquidity

Further, there was a failure to deal with liquidity matters and the focus upon capital under Basel II and III distracted regulatory attention away from the issues of liquidity that really did matter. As we shall see in relation to the collapse of HBOS this distraction and lack of focus by the FSA was actually a contributory reason for the collapse of that bank.³³ In particular, and it is documented below,³⁴ there was an incorrect focus upon capital at the expense of consideration of the liquidity issues affecting banks.³⁵ This led to regulatory inertia on a national and international basis. Regulators failed to take sufficient steps in relation to the liquidity of banks and over-concentrated upon capital standards. In the view of Parliament, this was an incorrect focus.³⁶ This lack of focus on liquidity matters by the FSA is an important matter highlighted in the studies involving Northern Rock, HBOS and RBS.

3. Stress testing

There was also a lack of stress testing. This might have helped in relation to liquidity. This is admitted as a failing by the FSA in relation to its regulation of Northern Rock.³⁷ After the bank collapses the approach of regulators has changed. Post the bank collapses, banks have stress tested more often, taking into account unemployment rates and house prices.³⁸ Banks did not appear to be looking at their liquidity positions should there be a general economic downturn or indeed specific problems in relation to particular countries. Once the banks realised that regulators were taking the matter seriously, then some banks did supply information by which they did fail the stress test, and there was greater compliance and greater transparency on the part of virtually all the banks.³⁹ That there was a lack of supervision and enforcement in relation to both Basel II matters, and liquidity matters and asset quality on the part of the FSA has been confirmed by the FSA itself:⁴⁰ "We have been on a journey towards a tougher style of supervision in all sorts of ways. That has a tougher style in relation to issues of substance like capital liquidity asset quality."

Hector Sants, then Chief Executive of the FSA, in giving evidence to the Treasury Select Committee in the October 2007 Hearings, looking at the Advanced Risk Responsive Operating Framework (ARROW)⁴¹ risk assessment model used by the FSA to assess risk, also pointed out that the FSA needed to look "more carefully" at stress testing matters when giving evidence about the FSA's use of ARROW⁴² in relation to the

collapse of Northern Rock. Professor Joanna Gray, writing about the collapse of Northern Rock considers that there were "real and significant failures in FSA's own supervision of Northern Rock".⁴³

In order to properly appreciate what went wrong and to learn the lessons from the failings of the FSA, the Northern Rock parliamentary report(s), the HBOS parliamentary report(s), the RBS parliamentary report(s) and the Libor parliamentary report(s) all need to be examined fully and their findings looked at in some detail. The FSA's "failure to pay sufficient attention to prudential matters"⁴⁴ will be discussed below.

F. Northern Rock -- the failure of the FSA to appreciate collapse of the wholesale funding market

The parliamentary report⁴⁵ concludes, in its summary, that the FSA "systematically failed in its regulatory duty"⁴⁶ regarding

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Northern Rock and the problems it posed for systemic risk. A number of failings on the part of the FSA were identified. In particular the FSA: (i) failed to identify the weakness in the Northern Rock funding model;⁴⁷ (ii) granted a waiver as regards capital requirements to Northern Rock and allowed it to pay a dividend when the FSA was concerned about liquidity problems in the banking sector;⁴⁸ (iii) adopted an inadequate approach to liquidity matters as the regulatory system on this was "flawed";⁴⁹ (iv) failed to adequately stress test Northern Rock properly by failing to stress test the consequences of a complete freezing of the international wholesale borrowing markets:⁵⁰

"... we did not engage in our supervised process in a way to my satisfaction with regard to the stress testing scenarios, because the stress testing scenarios which they were operating did not envisage the set of circumstances that transpired in August, which was a complete closure to them of all reasonable funding mechanisms, ... but I think as a regulator we should have engaged with that in an extreme stress test."⁵¹

Parliament's conclusion, also contained in its summary, was that the FSA "did not supervise Northern Rock properly. It did not allocate sufficient resources or time ... The failure of Northern Rock was also a failure of its regulator ...".⁵² The FSA then subsequently produced an internal report into its alleged failings as highlighted by Parliament. This was a starting point where Parliament had specifically criticised the approach of the FSA in its failure to properly and adequately assess the risks to which a bank was subject. The lack of stress testing of the liquidity positions of banks was confirmed by the Parliamentary Commission on Banking Standards in relation to HBOS.⁵³ "There was also an absence of forward looking stress testing of liquidity scenarios ...".⁵⁴

The failings of the FSA in relation to lack of stress testing of Northern Rock's liquidity scenarios were sadly repeated in relation to HBOS, discussed in the section covering HBOS below.

1. Internal report by the FSA into its failings in relation to Northern Rock

The internal report of the FSA⁵⁵ raised a number of criticisms about the way that the FSA had acted in relation to its regulation of Northern Rock. Although Northern Rock lending was growing rapidly, this was not factored into any extra risk assessment on the part of the FSA.⁵⁶ The indications of rapid expansion by Northern Rock should have led the FSA to reassess Northern Rock's business risk and to return to "more pro-active supervision".⁵⁷ A specific identified error on the part of the FSA was that it did not properly analyse the risks associated with the Northern Rock business model.⁵⁸ Despite several FSA visits to Northern Rock in relation to Northern Rock's application for a waiver in relation to Basel⁵⁹ there were no changes to North-

ern Rock's risk profile.⁶⁰ The conclusion was that, by end of the relevant period, there were failings in relation to stress testing and liquidity issues.⁶¹

This report mirrors the view of Parliament generally as shown in the various bank failures considered in this article. In particular, that insufficient attention was paid by the FSA to liquidity matters, and also that the FSA failed to require banks to stress test in relation to liquidity matters. These failures are themes running through the whole article and it is important to emphasise this, particularly as this liquidity has not been highlighted to such extent and with such importance elsewhere.⁶² These failings are in relation to risk, risk assessment, liquidity and stress testing. A further failing on the part of the FSA was that as Northern Rock was a high impact bank, the level of oversight and engagement fell below the appropriate standard.⁶³ There was a lack of formal records of FSA meetings with management and this was regarded as not complying with usual practice.⁶⁴

An interesting point to make here is that Parliament reached its conclusions and afterwards, the FSA made an internal report. The Treasury Select Committee in reaching its conclusions, described above, did not comment upon this internal report of the FSA which was made subsequent to its assessment. In terms of later regulatory failings on the part of the FSA (below), the approach of Parliament was to require the FSA to prepare a report into its failings which Parliament would then comment upon. Parliament would then appoint specialist advisors to make detailed comments. The internal report by the FSA into the collapse of RBS makes clear that the specialist advisors, Bill Knight and Sir David Walker offered their comments upon the report at its draft stage. Their comments were "considered" by the review team of the FSA.⁶⁵

This intervention by Parliament has been further extended in the HBOS inquiry, discussed below. The FSA is to provide the expert reviewers, Stuart Bernau, Iain Cornish and Sir Nicholas Monck with drafts of the FSA report.⁶⁶ Those appointed, if they consider it appropriate, are able to "invite the FSA to reconsider aspects of the report before it is published".⁶⁷ Thus there has been a development of parliamentary powers. This has resulted in increased ability to scrutinise the workings of the FSA by experts with specialised relevant experience and knowledge.

2. Evaluation of the Northern Rock situation and the report on Northern Rock

Although Northern Rock was expanding and the risks that it was taking also increasing, the regulator did not adjust its approach. In particular, there was a lack of challenge by the FSA of the financial decisions and approach being taken by senior Northern Rock management.⁶⁸ The FSA failed to challenge the information being provided to it by Northern Rock.⁶⁹ In particular the FSA showed a "lack of capacity to assess the quality of the data received".⁷⁰ One also gets a feeling that the internal report was made at quite a low level within the organisation, with parts crossed out and a very detailed look at the particular bank without putting it into any general analysis and how it would then actually affect the work of the FSA in its attitude and response to risk. Further, the lessons about maintaining liquidity were not learnt and the failure of the bank to stress test for the

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important areas that the business was dependent upon were repeated later on by the FSA in relation to HBOS and RBS. There needed to be a fundamental reassessment about risk by the FSA, and this did not happen.

G. HBOS and its collapse -- failure of the regulator to assess the risks and the growth of risks being taken by HBOS

The collapse of HBOS became the subject of a parliamentary report.⁷¹ The role of the FSA was examined in section 5: A failure of regulation. Having gathered much information the parliamentary report notes⁷² that the FSA gave increased freedom for management itself to identify, assess and control the risks to which HBOS was subject. The control of risk was to be a matter of self-regulation. Indeed, a letter was produced in evidence which made clear that the FSA was expecting HBOS to stress test and carry out appropriate analysis

of its important dependencies.⁷³ Subsequently, the regulatory emphasis on the part of the FSA shifted towards capital matters relating to HBOS and the implementation of Basel. HBOS was seeking to establish a position whereby the FSA would agree and allow HBOS to hold a lower level of capital. Management of the bank gave evidence to Parliament that the focus of the regulator moved towards the capital of HBOS and away from the liquidity of HBOS.⁷⁴

The conclusion of the Parliamentary Commission on Banking Standards (Fourth Report) was that the regulation by the FSA in relation to HBOS was inadequate,⁷⁵ and that the regulator missed opportunities to prevent the downfall of HBOS⁷⁶ because it wrongly focused on matters relating to capital rather than liquidity⁷⁷ and with too much attention paid to irrelevant matters.⁷⁸ Failure to deal with liquidity was also compounded by failure on the part of the FSA to stress test. This failure is a matter which has been dealt with earlier on.⁷⁹

In particular, the FSA did not follow through its concerns about the aggressive growth of HBOS and the dependency by HBOS upon wholesale funding.⁸⁰ The conclusion of the Parliamentary Commission on Banking Standards (Fourth Report) was that:⁸¹

"Too much supervision was undertaken at too low a level -- without sufficient engagement of the senior leadership within the FSA. The regulatory approach encouraged a focus on box-ticking which detracted from consideration of the fundamental issues with the potential to bring the bank down."

The point is that the FSA left the matter about the risks to which HBOS was subject, to HBOS and HBOS did not adequately control those risks. Thus, prudential regulation failed, although in this case it was not the sole reason leading to the collapse of HBOS. However, this conclusion by the Parliamentary Commission adds very little that is new. Professor Julia Black had commented in 2005,⁸² with regard to the assessment of risk, that regulators had to reject the approach of box ticking.⁸³ She added the further point that the employees of the FSA had been criticised by the Practitioner Panel for not adopting a strong enough risk-based approach to its regulation.⁸⁴ This view has been confirmed by Andrew Bailey whose view was summarised by the Parliamentary Commission on Banking Standards (First Report) as: "a tick-box culture amongst regulators meant that so long as firms complied with the rules, they were allowed to continue with practices that led to poor standards".⁸⁵

Similarly, in the view of Peter Cummings, former CEO of HBOS who gave evidence before the Parliamentary Commission on Banking Standards (First Report):

"... If they see me doing something about advance portfolio management, that is a tick in the box. If they see me doing something about a programme or a project about operational risk, and I set up a project management team to manage the operational risk project, and so on, that is a tick in the box for them."⁸⁶

However, Lord Turner gave evidence before the Banking Commission on Banking Standards. He was:

"... not totally convinced that this use of the word box ticking is the best characterisation of what went wrong ... I could argue that one or two ticks or crosses against some very important boxes -- such as sensible liquidity and capital rules -- might have been better than what we were doing ..."⁸⁷

1. Oral evidence before the Parliamentary Commission on Banking Standards

The Parliamentary Commission on Banking Standards (Sub- Committee B) Panel on HBOS (Tuesday 30 October 2012, HC 705-i) interviewed senior management involved in the risk side of the HBOS business. It was pointed out by Lord Turnbull (chairperson) that one of the reasons for interviewing employees was to

ascertain what warnings should have been given by the FSA which were not given by them.⁸⁸ The Head of Regulatory Risk, HBOS 2004, pointed out that the ARROW risk assessment by the FSA, in 2003 was serious and that he had never seen one as serious as that.⁸⁹ He agreed with the statement of Lord Turnbull, that, post- 2006, the FSA allowed two to three years of aggressive selling and lending to be continued.⁹⁰ Subsequently, the CEO International of HBOS gave evidence. In his evidence he was of the view that the internal funding plan produced by the bank did not foresee that the ability to borrow funds from the market would freeze.⁹¹ It was also confirmed by another witness, the Group Risk Director, that HBOS had not stress tested for the loss of ability to borrow funds in the wholesale market.⁹² "That [reliance by HBOS on wholesale funding] was never raised, for instance, by the FSA as a key risk to the business. I was not ever aware of that being in a specific stress test or whatever".⁹³ The questioning marks an important development in that the witnesses were questioned by counsel.⁹⁴ This confirms an important failing on the part of the FSA which would not otherwise be documented.

The Parliamentary Commission on Banking Standards (Sub-Committee B) Panel on HBOS (Monday 12 November 2012, HC 705-ii) (Panel on HBOS) interviewed senior

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management employed by HBOS. It was pointed out by Lord Turnbull (chairperson) that a reason for wishing to interview such employees was that the collapse of HBOS and the failings of the FSA had not been written up by the FSA in the way that had been done for RBS.⁹⁵ Again, the witnesses were questioned by counsel.⁹⁶ The view of the CFO of HBOS, at the relevant time, was that it was not possible to stress test the depth of the financial crisis.⁹⁷ Further in that employee's view, steps were taken by HBOS to deal with the points raised by the FSA Group ARROW Risk Assessment concerning HBOS.⁹⁸ Another witness, the Finance Director of HBOS, at the relevant time, made the point that the FSA "would then ask for either a further stress test to be performed or indeed sometimes further information...".⁹⁹ In his view what brought about the downfall of the bank was the complete closure of the wholesale markets, which was a matter not foreseeable by either the bank or the FSA.¹⁰⁰ It was "such an extreme scenario that it was just not foreseeable ...".¹⁰¹

A similar view was put forward by Sir James Crosby, Chief Executive, HBOS between 2001 and 2005, when examined by Rory Phillips QC: "The financial crisis as it emerged was a stress test beyond anything anyone had considered".¹⁰² He made the further point that: "no-one was stress testing for complete closure of the markets".¹⁰³ In the course of questioning Sir James Crosby, Lord Turnbull, the questioner, made an important observation:

"What you are coming to is a different story, which is the FSA having discovered precisely the two weaknesses that brought you down. One was a risky asset, particularly in corporate. The second was the funding model. Having found the treasure, you then buried it again and did not find it until 2007, and that is a problem of regulatory failure, which we as a Commission will need to investigate. But the warning signs were there."¹⁰⁴

The view of Parliament is that the FSA failed to spot matters it should have spotted. The Parliamentary Commission on Banking Standards (Sub-Committee B) Panel on HBOS (Friday 16 November 2012, HC 705-iii) heard evidence from the CEO, Corporate and Treasury, HBOS. He was employed by HBOS between 2001 and 2005. He was also examined by counsel. He indicated that there was a comprehensive dialogue between HBOS and the FSA regarding its commercial property book. In the view of the witness, the result of intervention by the FSA would be that either HBOS would respond and change or the FSA would withdraw its suggestion.¹⁰⁵ Lord Turnbull (chairperson) then indicated that there was a time lag during this period when the FSA did not do anything in particular in relation to HBOS:

"The Theme we are following is that there is a strong challenge from the FSA. Then there is the PWC's skilled persons report. Then there appears to be a kind of reconciliation between the two of you. You then have the Paul Moore episode and KPMG basically says it is alright to continue. Then somewhere in 06 this must have been after your time -- the FSA come back again. Again they are talking to HBOS as though you are not in special measures any more. Then you get to 2012 and they

write this thing saying your risk systems were completely inadequate and your successor and colleague gets very severely dealt with ...¹⁰⁶

The witness, George Mitchell, did not agree:

"... the FSA was not suggesting that the controls in place were unreasonable. What they were saying was that the controls in place were unreasonable to cope with the level of growth that took place in 2007. So I don't think it is quite as large a contradiction as that."¹⁰⁷

Subsequently, Parliament called an unidentified official from the FSA to explain the approach of the FSA in its regulation of HBOS. Again counsel was used to examine the witness.¹⁰⁸ The official confirmed that as a consequence of its focus HBOS "significantly tiered out its funding requirements"¹⁰⁹ and "also diversified its funding sources"¹¹⁰ both at source and geographically. Before the financial crisis the approach of the FSA was to ensure that HBOS had a diverse set of funds and did not lay down specific levels of funding.¹¹¹ Further, the approach of the FSA, before the financial collapse, was not to make a detailed assessment of the quality of the underlying assets contained within the books.¹¹² The view of Lord Turnbull, chairperson of that parliamentary committee, was that the type of lending of HBOS and its funding model were crucial matters that "the FSA missed ... just as much as the company".¹¹³ The answer of the FSA official to this question was "Yes".¹¹⁴ The point is that the regulatory failure of the FSA is being classified as one of negligence. It is unclear whether these errors could now be continued by the PRA in its prudential regulation.¹¹⁵

Several matters emerge. First, that there is a fragmentation of proceedings in Parliament with the coverage of HBOS the subject of different reports. Second, the use of specialist counsel to put very detailed lines of questions to the various witnesses adds detail, importance and reliability to the answers given. Third, an employee working within the FSA was questioned by counsel. This employee was responsible for the day-to-day prudential supervision of HBOS. Such information is not usually obtainable since the day-to-day work behind the scenes of the FSA is not normally the subject of litigation. Fourth, Parliament wanted to confirm that there were failings within the regulator of its prudential regulation of HBOS. Once this was established it would lead on to the FSA making a detailed and further report about its errors and omissions as had been provided in relation to RBS.¹¹⁶

2. The FSA report into its failings in relation to the loan book of HBOS

In the light of its findings, Parliament has asked Stuart Bernau, Ian Cornish and Sir Nicholas Monck to review the report that the FSA is currently preparing about the failure of HBOS. The report will focus on the loan book of HBOS.¹¹⁷ As part of this process, the FSA is to provide the reviewers with drafts of its reports. Where the draft report of the FSA is significantly altered, then the Treasury Select Committee is to be informed.¹¹⁸ This marks an important change of approach from whether the FSA has fallen below the

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standards expected of it to the various way(s) in which the FSA has fallen below the standards expected of it. The assumption is that more should have been done by the FSA.

3. Evaluation of the parliamentary report on HBOS

Two failings, in particular were identified. The failure to stress test was repeated showing that the regulator had failed to learn and implement the lessons of Northern Rock. Second, the failure to tackle the increase in risk to which HBOS was subject. The point is the changes in size and culture amongst the banking community. Banks are multinational entities operating on a world stage. Such organisations are prepared to take increasing risks. They have not wanted to lower their appetite for profit maximisation. On the contrary, HBOS

being an example -- they have shown a desire to ever increase their risk. With HBOS this growth and expansion was not challenged effectively by the FSA. In this one-sided world the banks have moved backwards, but the regulator's attitude and approach are unchanged. The suggestion, an idealistic hope perhaps, that meta-regulation as put forward by Professor Julia Black would mean that banks would curtail their desire to maximise profits and take risk has not happened.¹¹⁹ HBOS took ever increasing risks at consistent steps, and as part of a deliberate policy. In contrast the FSA did not take a more aggressive stance to this change in approach to risk on the part of HBOS. If these lessons are to be learnt the PRA will need to re-evaluate its approach to risk and will need to adjust its attitude. Not only will the PRA have to demonstrate more understanding of the risks being taken by a particular bank, but it will need to step in and demand changes of those banks that it seeks to regulate. This will require increasing understanding, will and desire on its part.

The focus of criticism against the FSA surfaced in relation to the Northern Rock collapse. It was the first collapse of a high street bank. Parliament was able to show, and the FSA agreed, that the FSA's lack of enforcement in relation to prudential matters was incorrect and needed change.¹²⁰ The academic discussion about Parliament has focused on what Parliament had to say about Northern Rock.¹²¹ The near collapse of HBOS and the failure of the prudential regulation in relation to that bank did not attract a similar volume of academic discussion. The failure with HBOS, as Parliament points out, was for two reasons. One was the inability of HBOS to obtain funding. This is similar to the problems facing Northern Rock. However, the second reason was the expansion of HBOS which went unchecked by the FSA. This is clearly a prudential failing on the part of the FSA and merits consideration in its own right. It was never fully explained why the FSA let matters develop the way they did and why, having spotted problems, it did not take action and allowed HBOS to continue its expansion of lending. The much debated too big to fail is here, too big to regulate. HBOS wanted to expand rapidly in order to maximise its profits. The regulator did not seem willing to match this reckless expansion with appropriate action. Negligence is one thing but it may be that the regulator lacked the will to tackle, head on, one of the larger banks. It was not fully or adequately explained as to why it did not act.¹²² Now that financial stability is a specific objective, it should lead to a more proactive prudential approach.¹²³ It will also lead to the regulator identifying systemic banks of importance and giving them additional attention.¹²⁴

4. Further lessons to be learned

There is to be a review as to the failings of HBOS¹²⁵ to describe and explain why HBOS failed and also to describe and explain the supervision of HBOS. This review will take place in the future and necessarily cannot form part of this article. The review will also assess the enforcement investigations carried out by the FSA in relation to the failure of HBOS. It will also look at the wider aspects of the RBS collapse not considered in the report of the FSA into the failure of RBS.¹²⁶ It will also make recommendations not covered by the FSA's own internal report into the failure of Northern Rock¹²⁷ and the Turner Review.¹²⁸ In particular, Andrew Green QC has been appointed to assess the FSA's enforcement (or lack of it) in relation to HBOS. The review has specific scope to consider whether the PRA/FSA should bring prohibition proceedings against former members of HBOS's senior management.¹²⁹

H. The collapse of RBS -- lessons not learnt for the third time

The collapse of RBS, after its takeover of ABN AMRO, has also been a matter that has attracted a House of Commons Treasury Committee report.¹³⁰

1. Report by the FSA of its alleged failure of its regulation of RBS

As a consequence of criticism of the FSA by Parliament of its regulation of RBS, and at the behest of Andrew Tyrie,¹³¹ the FSA produced its own report. As this report is specifically reviewed by Parliament, this report will be analysed and discussed in detail. Some of the main findings of this internal report by the FSA are outlined below.

The internal report makes clear, and re-emphasises the point that the supervisory approach of the FSA was not adequate as regards the core prudential issues concerning capital liquidity and asset quality.¹³² Also, the FSA failed to challenge risk assessments and management decisions.¹³³ Further, insufficient resources were devoted by the FSA to enable the FSA to undertake such an intensive and challenging approach.¹³⁴ There was a deliberate policy of low priority to liquidity, which the FSA accepted, with hindsight, was "inadequate".¹³⁵ The review points out that in relation to capital the approach of the FSA was "reactive".¹³⁶ In particular, the acquisition by RBS of ABN AMRO increased the dependence of RBS on short-term wholesale funding. The review indicates that the FSA frameworks in relation to the supervision of liquidity issues "were not adequate to identify and limit this dependence".¹³⁷ The review also

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indicates that the FSA adopted "a relatively low priority in relation to liquidity"¹³⁸ and that this approach was incorrect as liquidity was an important matter central to good supervision.¹³⁹ RBS expanded its lending in commercial property but the FSA failed to analyse the quality of these loans.¹⁴⁰ The conclusion on this was clear:

"...the FSA's overall philosophy and approach was flawed. There was insufficient focus on the core prudential issues of capital and liquidity, and inadequate attention was given to key business risks and asset quality issues."¹⁴¹

As regards the ABN AMRO acquisition by RBS¹⁴² the FSA was not sufficiently engaged in testing the liquidity and capital consequences for RBS of the acquisition.¹⁴³ Second, it did not sufficiently challenge the due diligence that RBS carried out¹⁴⁴ (which was in fact defective in scope and depth).¹⁴⁵ Third, the FSA did not have a defined approach in relation to takeovers.¹⁴⁶ Fourth, the FSA wrongly relied upon the internal business model and internal decision-making within RBS.¹⁴⁷ Fifth, the FSA wrongly assumed that RBS would be able to manage the acquisition from a capital viewpoint,¹⁴⁸ which proved incorrect, despite a rights issue. Sixth, the FSA believed that RBS could only run into liquidity difficulties in an "extreme scenario" which was considered to be "very unlikely". This view was shown to be wrong.¹⁴⁹ Seventh, in dealing with takeover situations, the approach of the FSA should be more intrusive.¹⁵⁰

The internal report prepared by the FSA continued to deal with some of the failures of management at RBS but also failures of the FSA as regulator. The internal report confirms that the FSA concentrated on capital requirements but did not look at the leverage on the RBS balance sheet.¹⁵¹ The focus of the FSA was too narrow and the FSA supervision team's model (VaR model) that was used did not enable that team to sufficiently understand the risks connected with RBS's trading.¹⁵² In particular, too little attention was placed on liquidity matters by the FSA so that the supervisory framework for this (the SSR) was "seriously flawed".¹⁵³ Liquidity issues were given low priority, with too much attention paid to capital matters.¹⁵⁴ In particular the SSR did not cover RBS's dependence upon wholesale funding.¹⁵⁵

The internal report also confirmed that the supervisory approach of the FSA was deficient in that it only wanted to act in reaction to a problem relating to liquidity.¹⁵⁶ This was, as the internal report notes, despite previous concerns with the SSR in relation to liquidity matters as identified in the Northern Rock report.¹⁵⁷ Although the FSA took an increasing interest in liquidity matters, the internal report notes that this proved too late to save RBS.¹⁵⁸

The internal report notes another failing on the part of the FSA, namely its limited analysis of the balance sheet and the asset quality of RBS. In particular, the FSA failed to follow through the major increase in exposure due to RBS's level of commercial property lending and did not intervene in relation to this.¹⁵⁹ Further, the approach of the FSA was that of allowing the firm to monitor itself by stress testing, namely self-regulation, rather than any substantive regulation.¹⁶⁰

"... the focus was primarily on encouraging the firm to improve its own stress-testing methodologies. This focus on management process for assessing asset quality, rather than substantive analysis by

the FSA of a firm's asset composition and quality ... was characteristic of the FSA's pre-crisis supervisory approach."¹⁶¹

Given the increase in commercial lending by RBS, the supervision team incorrectly failed to review their earlier judgement that stress testing was sufficient. The internal report of the FSA concluded the FSA's inability to revisit its earlier judgement was "a weakness in the FSA's supervision".¹⁶² Again this type of weakness had previously been shown and identified in the earlier internal report of the FSA in relation to Northern Rock.¹⁶³

The internal report then considers the regulation of RBS's structured credit by the FSA. The conclusion is that there were three failures in relation to it.¹⁶⁴ The first failure is a too narrow focus by the FSA on individual institutions rather than systemic risks so that the development of the market for this was not looked at by the FSA.¹⁶⁵ The second failure was the approach of the FSA to assessing risks in the trading books of RBS.¹⁶⁶ The third failure was the approach by the FSA to investment banking activities -- an approach which was considered to be very limited.¹⁶⁷ This reflected the self-regulatory nature of FSA regulation, which was "not to challenge firms' business models and their inherent risks, but instead to focus on systems and controls".¹⁶⁸ In particular, the FSA did not challenge the overall approach taken by RBS, prior to 2007.¹⁶⁹ The FSA did not focus on the credit risks contained within the trading book of RBS.¹⁷⁰

Given the significance and size of the acquisition by RBS of ABN AMRO, the overall response of the FSA was inadequate.¹⁷¹ The FSA had no specific approach to important takeovers.¹⁷² Further, "the prevailing FSA philosophy and approach were that strategy, business model and key business decisions were matters for firms' senior management and boards",¹⁷³ which the conclusion stated was a "significant mistake".¹⁷⁴ However, because of the size of the acquisition, which was the biggest in banking history, the FSA should have exercised its judgement and should have considered whether the risk being taken by RBS was acceptable.¹⁷⁵ Although the FSA did have concerns about the liquidity of RBS should the takeover of ABN AMRO take effect, it was considered "very unlikely"¹⁷⁶ that those risks would materialise.¹⁷⁷ The conclusion of the internal review team of the FSA was that the FSA had taken "limited account of the very substantial uncertainties and risks".¹⁷⁸

An important conclusion was that too much attention had been paid by the FSA, in its regulation, to capital matters. In future, in line with the recommendation of the Turner Review¹⁷⁹ equal attention must be paid to both liquidity as well as the capital of banks¹⁸⁰ and also, when the FSA stress tests banks.¹⁸¹ The FSA confirms that its weakness as a regulator was that it relied upon the senior management running the bank, namely self-regulation, to ensure that the bank was controlling its risks. What the FSA failed to do was to make its own enquiries.¹⁸² The approach of the FSA was one that focused on process, systems and structures, which "tended to be at the expense of focused, detailed and quantitative attention to the core prudential issues".¹⁸³ The philosophy of the FSA was not to question the overall strategy of the

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bank.¹⁸⁴ Those individuals responsible for regulation did not reach their own judgements on the strategic risks of the bank's business model.¹⁸⁵ There was also the concentration by the FSA on the treatment of consumers by firms instead of prudential matters, which the internal review confirmed were regarded "as more pressing and important".¹⁸⁶ This failure was confirmed from the analysis of the Risk Committee minutes of which the November 2005 Risk Committee was looked at.¹⁸⁷ There was also the failure to bring prudential matters before the FSA board. The minutes of the FSA board between January 2006 and July 2007 which were looked at: as regards major matters one out of 61 related to prudential risks; as regards matters within the CEO's report only one out of 110 matters related to prudential risks; of 229 items reported by the managing director of retail markets (who was responsible for major banking groups such as RBS) there were five items relating to prudential issues.¹⁸⁸

The lack of focus on prudential matters was confirmed by the Parliamentary Commission on Banking Standards.

"Prudential risk issues appeared to be scarcely on the FSA Board's radar screen. According to the FSA's Report, The Failure of the Royal Bank of Scotland, an analysis of the FSA's Board minutes during the 19 months prior to the financial crisis showed that of the major topics discussed, only one out of 61 related in some way to bank prudential risks, just one out of 110 items reported to the FSA Board within the CEO's report were prudential issues, and of 229 items reported by the Managing Director of Retail Markets to the Board, only five were prudential issues¹⁸⁹ ... In their report into the failure of RBS, the FSA accepted that prudential supervisors did not sufficiently assess and challenge key strategic decisions and business model risks. As a result, banks were able to adopt aggressive growth strategies aimed at maximising short term profits."¹⁹⁰

The Parliamentary Commission on Banking Standards (First Report) reviewed the internal FSA report and made comments in relation to it:

"The FSA pointed out in their Report, The Failure of the Royal Bank of Scotland, that failings were the result, in part, of a 'light-touch' approach to regulation which arose from 'a sustained political emphasis on the need for the FSA to be "light touch" in its approach and mindful of London's competitive position.' That same report identified deeper failings, both to look at the right issues and to draw lessons from the issues they did examine, which can be summarised as a neglect of prudential risk and putting form before substance in conduct regulation."¹⁹¹

2. The report of Parliament about the report by the FSA into its alleged failure of its regulation of RBS

As will be seen, it has become common for Parliament to request the FSA to make an internal report and for Parliament to appoint specialist advisors who would then review the internal FSA report. Subsequently, Parliament appointed two specialist advisors, Sir David Walker and Bill Knight to review the report by the FSA into its alleged failure of regulation of the RBS bank.¹⁹² Bill Knight concluded that, in general, the employee staff of the FSA carried out their duties as expected, but that what was expected of them was wrong. This was a failure of senior management.¹⁹³

"The FSA Report describes failures and inadequacies in the regulation and supervision of capital, liquidity, asset quality and a failure appropriately to analyse the risks relating to the ABN AMRO acquisition. This is a serious indictment of both senior management and leadership ..."¹⁹⁴

The funding of ABN AMRO by RBS was by debt and it had the consequence that RBS was increasingly reliant upon short-term wholesale funding. Despite this, Hector Sants made clear that RBS were not in breach of threshold conditions.¹⁹⁵ In the light of this Hector Sants was of the view that the FSA had no power to intervene.¹⁹⁶ This view was challenged by Sir David Walker, who considered that the FSA could have set a capital buffer for the combined entity merged together that would have made the merger unattractive commercially.¹⁹⁷ The conclusion was that the FSA was not making full or proper use of its powers.¹⁹⁸ The witnesses for the FSA were never called back to either challenge or agree with this conclusion, which might have been done and perhaps leads to a weakness in that the issue is not ultimately, clearly determined. The FSA Board Report made the point, without conclusively accepting it -- that "Arguably the FSA, if really determined, could have blocked the takeover by other less direct means".¹⁹⁹ Also, the FSA Board Report suggests a similar possible approach, in that: "Irrespective of the formal position, however, it is arguable that the FSA could and should have used other mechanisms to prevent the acquisition".²⁰⁰

Whilst the FSA Report "questioned"²⁰¹ the FSA's approach in not creating a team to review the risks connected with the RBS acquisition of ABN AMRO, the expert appointed by Parliament was much more critical.

In particular, more should have been done by the FSA in its examination of the risks connected with the merger.²⁰²

3. Direct evidence of Lord Turner, Hector Sants and Margaret Cole of the FSA before the Treasury Committee

Hector Sants, in response to question 117, indicated that there was no formal requirement for the FSA to approve the acquisition by RBS of ABN AMRO.²⁰³ Hector Sants went on to say that "the only basis under which we could have intervened would be if we had concluded that the bank, on completion of the transaction, would not meet the threshold conditions".²⁰⁴ This was not accepted by the expert reviewer, Sir David Walker but the difference of view necessarily remains untested.²⁰⁵ In such a situation it is suggested that the regulator witness should be briefly brought back to clarify whether he/she still maintains their previous view or whether they now agree the approach of the expert.

Hector Sants and Lord Turner were called to give evidence before the Treasury Committee.²⁰⁶ In response to question

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95, Hector Sants indicated that he would like to see changes to the regulatory framework so that if in the future individuals in positions as senior executives running a bank made a number of misjudgements (serial misjudgements) "which means that they are not fit to run a regulated institution ... which demonstrates they are not competent", the FSA (the regulator) would be able to take action against them. Lord Turner, in response to question 97, indicated that any enforcement action, according to the best advice of "our enforcement lawyers", would have to show a lack of technical ability of the individual in a very specific way or that the senior executive did not follow a particular procedure. In the view of Lord Turner, the fact that a senior executive made a number of misjudgements, as the law then stood, would not be sufficient for the FSA to take action and subsequently win an appeal before the courts.²⁰⁷

4. Enforcement action(s) and the internal report of the FSA relating to RBS

The internal report of the FSA, discussed above,²⁰⁸ deals with the enforcement division's work relating to whether it would be able to bring disciplinary action(s) for misconduct relating to the collapse of RBS. The enforcement division decided not to proceed with enforcement action.²⁰⁹ In order to proceed with enforcement it would be necessary to show actions which were dishonest, reckless or incompetent.²¹⁰ The enforcement division wanted to investigate whether the RBS board had been fully involved in the decision process relating to the acquisition of ABN AMRO and whether it had received sufficient information to determine whether to proceed with the acquisition.²¹¹ Whilst the decision to proceed with the acquisition was a "bad"²¹² decision it was not as a consequence of fraud or dishonesty.²¹³

The internal report specifically deals with the acquisition of ABN AMRO by RBS which it calls a "misjudgement or catastrophic consequences".²¹⁴ The enforcement division of the FSA concluded that the due diligence by RBS was insufficient²¹⁵ and it was limited by lack of access to the balance sheet of ABN AMRO.²¹⁶ The advice from the solicitors acting for RBS was that the RBS board had given the takeover adequate consideration.²¹⁷ The RBS board was also advised by its solicitors as to whether it could exercise its material adverse change clause in the light of general market deterioration, but RBS still wished to proceed with the acquisition of ABN AMRO. The FSA took into account the fact that this advice had been obtained.²¹⁸ The internal report then continues by summarising why the FSA did not take enforcement action in relation to the ABN AMRO acquisition. There was no evidence that "knowingly inaccurate or unreliable due diligence information was presented to or withheld from the Board"²¹⁹ or that board members had been pressurised into approving the acquisition.²²⁰ Indeed, relevant legal advice had been obtained by the board²²¹ and the due diligence findings were "transparently communicated to investors".²²² In the light of the above a successful enforcement action was felt not to be possible and the deficiencies would not be sufficient for a successful enforcement action.²²³

Issues relating to capital, risk, asset quality, and stress testing, have been considered throughout and feature in the various case situations. The internal report of the FSA does state that the FSA did consider whether it should take enforcement action(s) in relation to RBS's systems and controls relating to its capital position.²²⁴ RBS did not break the rules relating to capital so there was no substantive breach.²²⁵ However, the controls of RBS in relation to capital may have been inadequate as it did not know whether it had broken its capital requirements.²²⁶ This was regarded by the FSA as a process breach.²²⁷ The enforcement division considered, in the light of the above, that it would not be appropriate to take action.²²⁸ Further, such approach "was consistent with the approach that the FSA took at the time -- i.e. it was aware of the matter and chose to address it by means other than enforcement".²²⁹

It is possible to argue, in a general sense, that the lack of effective regulation may have had a knock-on effect. It is possible to suggest, though difficult to prove, that the regulator was reluctant to take enforcement action²³⁰ against any senior individuals within defaulting banks as it would expose the regulator's lack of action(s). Furthermore, such individuals might be able to mount an effective defence simply based upon the lack of actions taken by the regulator. The defence would be to the effect that as you the regulator did not require us to take certain actions, such as say stress testing, how can you now complain and seek to impose liability upon individuals within the bank for not stress testing? What is known is that there was almost a complete lack of enforcement action involving fines or bans against any senior management in Northern Rock, HBOS, and RBS.²³¹

It is suggested that the FSA should have been more dynamic in its approach and should have tested the matter at a high level in the court system. If the FSA's view was shown to be correct then it would be able to say to Parliament that new powers were required. At least it would be able to confirm to the public that it genuinely was not able to act and placate public concerns about its lack of action.

5. Evaluation of the parliamentary report on RBS

A third report by Parliament again suggested that the lessons may not have been learnt by the FSA. The takeover by ABN AMRO by RBS reduced the capital and liquidity of RBS. This was not stress tested by the bank or by the FSA despite two major, previous, reports of Parliament which identified the importance of liquidity. Again, despite the importance of this report it has received comparatively little attention in the legal academic literature. Matters of substance and the actual risks being taken by RBS were not fully examined. Interestingly, the FSA incorrectly considered that it did not have power to intervene. It is crucial, particularly from a legal perspective that the regulator is clear as to its powers and is comfortable as to their use. Large banks will necessarily be well advised legally and in this case, this was a further reason put forward by the FSA for not taking action. However this balance of power between regulator and economically powerful bank has again not been the subject of much sociological discussion in legal academic circles and will not be discussed at length or further in this article.²³²

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6. Enforcement action

There has been some evidence of legal activity in relation to disciplinary and other actions against individuals²³³ and some reported case law.²³⁴ The decision in *Pottage v FSA*²³⁵ in which the FSA was directed by the Court of Appeal not to take action against Mr Pottage perhaps indicates that a regulator might face difficulties in pursuing regulatory actions against individuals employed in senior management positions.²³⁶ There is to be a report by the FCA/PRA in relation to the failure by HBOS and the review will have scope to "assess the reasonableness of the scope of the FSA's enforcement investigations in relation to the failure of HBOS".²³⁷ The review will receive an opinion from counsel²³⁸ and will "consider afresh whether any other former members of HBOS's senior management should be subject to an investigation with a view to prohibition proceedings".²³⁹

I. Libor

Although this situation does not concern the failure of a particular bank, the comments of the Commons Treasury Committee do indicate quite clearly that that committee did regard the Libor situation as raising matters of prudential regulation. The scandal of the alleged fixing of Libor, with its effects upon interest rates is the subject of ongoing criminal investigation. In its wake senior management within Barclays resigned and were called to give evidence before the House of Commons Treasury Committee.²⁴⁰ The Committee not only considered the failings of senior management within Barclays, but also looked at the role of the FSA and whether it had acted appropriately. The House of Commons Treasury Committee concluded there were failings in the approach and effectiveness of the FSA in its prudential regulation. The FSA was two years behind the investigations being carried out by the US regulatory authorities in starting formal investigations.²⁴¹ Further, such delay was a contributing factor in the perceived weakness of London as a regulator of its financial markets.²⁴² The Committee also concluded that there were "shortcomings" on the part of the FSA.²⁴³ In particular, that the FSA, as prudential regulator, failed to appreciate the importance of market rumours relating to the manipulation of Libor.²⁴⁴ The fact that there were concerns on the part of House of Commons Treasury Committee about the FSA simply as a prudential regulator in relation to the Libor issue indicates why this issue merits some consideration in this article.²⁴⁵

Lord Turner in giving evidence to the House of Commons Treasury Committee, about the final notice in relation to the investigation of Barclays, made the comment that when he looked at paragraph 131 of the final notice someone from Barclays had said that Barclays were "being clean in principle, but we're ... not being clean clean".²⁴⁶ Lord Turner then asks himself a question -- "why didn't somebody [somebody within the FSA] put up a red flag?"²⁴⁷ The answer that Lord Turner gave to this question, that he asked himself, was that this statement from Barclays was one of many statements.²⁴⁸ Second, this statement was only dealt with at junior level and never brought an important conclusion about the effect of self-regulation on the attitude of the regulator.²⁴⁹

"I return to the fact that there was simply a mindset that if there were problems here it was for the BBA (British Bankers Association) to solve them."

The British Bankers Association, operating through a private company was the organisation that was responsible for Libor. There was a system of self-regulation in place. The FSA had over-relied upon this self-regulatory system. In short, and in conclusion, it was a classic example illustrating "regulatory inertia" and a failure of self-regulation. The matter does not rest there for there are now allegations of similar type of collusion in relation to the Forex market, which is self-regulated, with a rate that is determined by traders. A small group²⁵⁰ of these traders are alleged to have made large profits by manipulation of this exchange rate. This situation has been described as "an unwelcome echo of the Libor benchmark interest rate manipulation...".²⁵¹ There have also been allegations that officials within the Bank of England were made aware of attempts to rig the market. It has been alleged that there was a failure to pass such concerns on to senior management. It is understood that one member of staff of the Bank of England has been suspended and a law firm called upon to conduct an independent investigation.²⁵²

1. Turner Review

Having just quoted from the mindset of Lord Turner above it is appropriate here to say a few things about the Turner Review.²⁵³ The failings and suggested reforms have been described elsewhere by others.²⁵⁴ However Lord Turner did identify several matters of particular relevance for this article. Discussing the FSA's supervisory approach Lord Turner made clear certain particular failings: first an incorrect concentration by the FSA on systems and processes "rather than on challenging business models and strategies",²⁵⁵ over-concentration on consumer matters rather than prudential matters,²⁵⁶ a "skewed" approach to Basel II and capital matters which "was mistaken since ... it meant that insufficient attention was paid to growing risks in trading books".²⁵⁷ Lord Turner was called before Parliament to give evidence before various committees, but he took the opportunity to answer and address the criticisms of Parliament about the prudential failings of the FSA in his own report. His admissions about over-concentration on capital matters at the expense of liquidity matters confirm his agreement to the criticisms of the regulation by the FSA of HBOS contained in the parliamentary commission's report on the failure of HBOS.²⁵⁸ The terms of reference of the HBOS review²⁵⁹ by the FSA/PRA into the failure of HBOS Plc,²⁶⁰ has "scope"²⁶¹ to "make any recommendations...that have

not already been covered in the previous reports, specifically ... The Turner Review". The dialogue between Parliament and regulator continues.

2. Evaluation -- in terms of responsiveness

Professors Julia Black and Robert Baldwin have indicated²⁶² the importance of risk assessment in order for the regulation to be responsive. In relation to Libor and the report of

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Parliament, there was a specific finding by Parliament that the FSA failed to respond quickly. The Hampton Review²⁶³ and the book by Ayres and Braithwaite²⁶⁴ also confirm the need for risk assessment. The failings of the FSA described above were a failure of self-regulation. By definition it was also a failure to be responsive, and responsive of the need to assess the risks being taken by banking institutions. The discussion in relation to RBS above shows two things in particular. First, that the error by the FSA concerning lack of supervision of liquidity in relation to Northern Rock was repeated in relation to RBS. This shows a lack of response and a failure by the FSA to change its approach speedily. Second, with RBS the FSA left it to RBS to stress test, and to stress test matters affecting liquidity. RBS did not do this properly or effectively, but the point is that it was a failure of self-regulation. A similar failure on the part of the FSA was shown with HBOS, where the assessment of risk was left to the bank by the FSA. This demonstrates another failure in self-regulation. With the analysis of the failure of regulation in the US (considered in the next section, section J below), it is established that there was a clear failure to take enforcement actions or proceedings by the regulators, even though the regulators did possess the necessary powers and knew exactly what was going on.

Professors Julia Black and Robert Baldwin are also of the view that in order for there to be responsive regulation, the regulator must have the appropriate tools.²⁶⁵ As regards individual enforcement action against particular individuals, the FSA has indicated that it believed that it did not have the necessary powers. This shows a lack of ability to be able to respond in a positive way. There was also a mindset not to take enforcement action and deal with breaches in other ways.

J. A comparative analysis -- regulatory failure in the US

An analysis of similar types of parliamentary reports from the US can and will be made. Again, the methodology is to search through the various congress and senate websites to see what reports have been made. One report of particular importance and relevance is the report of the United States Senate Permanent Sub Committee on Investigations, Committee on Homeland Security and Governmental Affairs, *Wall Street and The Financial Crisis: Anatomy of a Financial Collapse Majority and Minority Staff Report Permanent Sub Committee on Investigations* (United States Senate, 13 April 2011).²⁶⁶ The subsequent discussion draws from information contained in this important report. The report does analyse and reach important conclusions about prudential regulation in the United States of America from 2004 onwards, and it will be this that will be focused upon.

1. Washington Mutual Bank and failure by regulators to take enforcement action

Part IV of the report deals mainly²⁶⁷ with regulatory failure and the collapse of Washington Mutual Bank referred in the report as "WaMu", which will be adopted in this article. There was the joint Federal Deposit Insurance Corporation, the "FDIC".²⁶⁸ The Office of Thrift Supervision (OTS) was the primary regulator.²⁶⁹ The FDIC was a joint, secondary regulator because WaMu was an insured depository institution.²⁷⁰ WaMu collapsed on 25 September 2008.²⁷¹ It was placed into receivership by the OTS, and the FDIC, as receiver, sold it immediately to JPMorgan Chase for \$1.9 million.²⁷²

The fundamental weakness in the prudential regulation of WaMu, according to the Senate report,²⁷³ was that despite the fact that over 500 weaknesses were identified by OTS examiners, between 2004 and 2008, not

one public enforcement action was taken against this bank, even though the bank failed to take action to correct these deficiencies.²⁷⁴ There were important consequences as a result of failings in the prudential regulation of WaMu, which, because of their importance, merit identification. WaMu was allowed by its regulators to sell off hundreds of billions of dollars of its risky loans to other banks and financial institutions which was identified as being "a proximate cause of the financial crisis".²⁷⁵ Further, the OTS impeded the FDIC from being able to take enforcement action by rejecting the requests by the FDIC for access to loan files, thereby stopping the FDIC from being able to effectively review such files.²⁷⁶ The OTS, the primary federal regulator of WaMu, opposed FDIC wishes to take enforcement action.²⁷⁷ However, the FDIC entered into an arrangement, from 2002, with primary bank regulators, that if the primary regulator failed to take enforcement action then the FDIC would be able to initiate its own enforcement actions concerning insured institutions.²⁷⁸

The OTS handbook requires the OTS to undertake proactive regulatory supervision.²⁷⁹ All the federal regulators, which include the OTS, used the CAMELS system covering Capital Adequacy, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to market risk.²⁸⁰ The regulators have various levels of response: first, an observation, which is a finding of weakness not of regulatory concern; second, recommendations, which are included in the formal report and which are followed up and reviewed subsequently; third, criticisms, which are matters of primary concern requiring corrective action and are subject to follow up by examiners, and if not corrected may result in stronger corrective action; fourth, a matter requiring immediate board attention.²⁸¹ However, the OTS did not object to WaMu's high risk lending strategy, even though WaMu had not presented any plan to manage this greater risk.²⁸²

"WaMu had sold or securitized the majority of the loans it had originated or purchased, undermining the U.S. home loan mortgage market with hundreds of billions of dollars in high risk, poor quality loans. OTS documentation shows that WaMu's regulators saw what was happening, identified the problems, but then took no enforcement actions to protect either Washington Mutual or the U.S. financial system from the bank's shoddy lending practices."²⁸³

WaMu had, from 2004 to 2006, a 2 CAMELS rating.²⁸⁴ The FDIC supported a 2 CAMELS rating throughout 2007.²⁸⁵ On 1 August 2008, the FDIC wanted the OTS to downgrade

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WaMu to a 4 CAMELS rating (a rating which would be that WaMu was engaging in unsound and unsafe practices) which the OTS did not wish to do. In September 2008 the FDIC did downgrade WaMu to a 4 CAMELS rating. However, on 25 September the OTS shut WaMu and the FDIC, as receiver, sold WaMu to JPMorgan Chase for \$1.9 million dollars.

The report indicates throughout, concerns about WaMu by the OTS, but failure by WaMu to take steps to alter its behaviour, and failure by the OTS to compel performance of improvement.²⁸⁶ The report quotes from the evidence of John Rymer, FDIC Inspector General, who was of the view that "I don't think forceful enough action was taken".²⁸⁷ WaMu's risk officer, Ronald Cathcart explained that the approach of the OTS was one of self-regulation:²⁸⁸ "I would say that the OTS did believe in self-regulation."

WaMu's risk officer from 2004 to 2005 gave evidence that examiners of the OTS received little support from senior management. When an OTS official sought to stop WaMu from granting mortgages when WaMu did not verify the incomes of the respective borrowers, senior management within the OTS did not allow action to be taken.²⁸⁹ "What I cannot explain is why the superiors in the agencies didn't take a tougher tone with the banks given the degree of ... negative findings ... By a more active stance, I mean putting the bans under letters of agreement and forcing change." One reason for this was that the OTS simply looked at short-term profits. When the profits from mortgage lending were high during the property boom, the OTS used this as an excuse for allowing WaMu to engage in risky lending practices and for ignoring the systemic implications of WaMu's conduct.²⁹⁰

2. Countrywide Financial Corporation

Similarly, no enforcement actions were taken against Countrywide Financial Corporation by the OTS.²⁹¹ When the sub-prime mortgage crisis hit the US, it was not able to securitise its mortgage lending, and it was sold to the Bank of America for \$2.8 million before it went into liquidation.²⁹²

3. IndyMac Bank

As with WaMu, a high CAMELS rating was given by the OTS to IndyMac Bank despite sloppy mortgage appraisal practices by the bank, poor underwriting, and improper risk mitigation.²⁹³ No public enforcement actions were taken by the OTS.²⁹⁴ The OTS was aware of the bank's problems.²⁹⁵ The report refers to a review by the Treasury Inspector General²⁹⁶ which concluded that the OTS "did not take sufficient enforcement action".²⁹⁷ The collapse of IndyMac Bank, which was insured by the FDIC, resulted in a payout from the fund of \$10.7 billion.²⁹⁸

The conclusion was that there were a number of regulatory failures and "WaMu's collapse marked one of the most spectacular failures of federal bank regulators in recent history".²⁹⁹ The Dodd-Frank Act abolished the OTS and its duties and personnel were transferred to a new institution, the Office of the Comptroller of the Currency (OCC).³⁰⁰ In some ways, this mirrors what happened in the UK: the abolition of the FSA and the transfer of its powers and personnel to the FCA/PRA.³⁰¹ The PRA is now specifically responsible for prudential regulation. Previously with the FSA, there was no specific divide of that sort so that the FSA was structurally not set up to regulate prudentially.³⁰²

4. Conclusion that regulators in the US deliberately failed to take action

The written statement (testimony) of Orice M Williams, Director Financial Markets and Community Investment, of the United States Government Accountability Office, Before the Subcommittee on Securities, Insurance and Investments, Committee on Banking, Housing and Urban Affairs, US Senate -- Financial Regulation Review of Regulators' Oversight of Risk Management Systems at a Limited Number of Large, Complex Financial Institutions, 18 March 2009³⁰³ confirms the view that the regulators did not take sufficient action. Throughout this statement, the comment is that the regulators did not fully appreciate the risks or weaknesses of the institutions being regulated³⁰⁴ and "relied on management representation of risk"³⁰⁵ which was inaccurate. There is also the comment that regulators failed to take sufficient action to remedy the deficiencies of which they were aware.³⁰⁶ "We found that the regulator continued to find some of the same weaknesses in subsequent examination reports, yet examiners did not take forceful action to require the institution to address these shortcomings ...".³⁰⁷ There is a section in the statement headed "Regulators Identified Weaknesses in Models Used to Calculate Risk but May Not Have Acted on These Findings".³⁰⁸ In a later part of the statement, there are comments about the failure of the US regulatory authorities to take action when they were aware of failure:

"We found that regulators had identified numerous weaknesses in stress testing at large institutions before the financial crisis. However, our limited review did not identify any instances in which an institution's lack of worst-case scenario testing prompted regulators to push forcefully for institutional actions to better understand and manage risks..."³⁰⁹

K. Comparison between UK and US regulatory failure

We have just seen with WaMu, that the bank massively expanded its lending. WaMu was careless in the way that it lent by allowing borrowers to verify their incomes and also in failing to verify incomes of its borrowers. The consequence was that it needed to sell off its loans through securitisation. Similarly with HBOS, in the

UK, the bank greatly expanded its lending, and had lax controls in relation to that lending. Although HBOS was involved in the securitisation of its loans, it was dependent on wholesale funding.

However, the US regulatory authorities seemed more aware of what was happening but lacked the willingness and desire to take any decisive action. In legal terms, perhaps the US regulators wilfully and recklessly turned a blind eye to what was going on. In contrast, there was

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perhaps more dialogue between regulator and bank in the UK. HBOS stress tested as requested by the FSA. The failing in this approach was that HBOS did not stress test for a complete ending of all funding from the wholesale funding markets. This was an inadvertent failing by both HBOS and regulator. This failing on the part of the regulator might be classified as essentially one of negligence. The report of the FSA in relation to RBS also confirms a failure of regulation in the sense of negligence, in that the FSA failed to analyse relevant risks.

1. Confirmation of failings by the FSA

It might be possible to reduce bank failures by having very great regulatory input. This might stifle lending as banks might have to massively increase their capital or retain larger parts of it. The other extreme approach would be to have no system of regulation. How much risk taking a regulator should allow cannot be answered simply.³¹⁰ The PRA needs to know what risks banks are subject to and be "... fully appraised of what these risks are"³¹¹ and that banks "have adequate systems in place...".³¹² These are obvious practical steps that need to be taken.

The problem is that the statutory system of regulation, previously undertaken by the FSA, now by the PRA (particularly the PRA as prudential regulator) and the FCA, does not make clear what the approach should be. Though the Financial Services Act 2012 added a new statutory objective of financial stability, this is not enough for it does not address the issue of risk. The parliamentary reports have been critical about the lack of regulation and lack of effectiveness on the part of the FSA. The failures of the FSA show a lack of desire within the FSA to investigate matters relating to risk which the FSA believed to be outside its ambit. As was made clear in relation to the RBS collapse, the FSA did not have the resources to investigate all the banks under its remit.

In the UK, the regulator did not fully appreciate the risks that the particular bank was subject to. As regards Northern Rock and HBOS, the FSA failed, twice, to stress test for the complete collapse of the wholesale markets. As regards the takeover of ABN AMRO by RBS, the FSA underestimated the risks to which RBS would be subject. This takeover was funded by debt not equity, and allowed to be funded in this way by the FSA. This put RBS into liquidity difficulties, which, again, might have been avoided. The FSA has stated in public, before Parliament, that it incorrectly concentrated on capital matters at the expense of liquidity issues. As regards Libor, the FSA delayed its response. The reports of Parliament confirm a pattern of failure on the part of the FSA. In the UK, there were failures, in the negligent sense, to take appropriate action. Parliament has requested the FSA to make internal reports to identify its failures so that these errors can be identified, learnt about, and not repeated.

In the US, the regulators knew that particular banks were taking excessive risk, involving large amounts of mortgage lending, but chose not to take action. It was as if the regulators, in the US, did not want to regulate but wanted the banks to self-regulate instead. In the US, the regulators deliberately, wilfully and recklessly turned a blind eye to what was going on. The massive securitisation of mortgage lending was ignored by the OTS, who had specifically identified this as a problem. In both countries, for different reasons, decisive action was not taken. However in both the UK and the US it has been demonstrated that regulators were acting carelessly or recklessly.

2. Reform in the UK

In theory, the PRA is responsible for day-to-day regulation and the FCA is responsible for taking action in relation to the enforcement of this prudential regulation. The advantage of having these two bodies within the Bank of England is that day-to-day regulation (prudential regulation) can be combined with general macro-economic regulation, and there is one organisation monitoring both. The separation of powers between the FCA and the PRA is clear in principle. Indeed, it makes sense for the PRA to investigate and decide that a particular institution is acting in breach of the rules and for the FCA to then bring action before the court. This separation of powers in this context protects the regulatory bodies from arguments that the human rights of the bank have been infringed. The reforms mean a specialised organisation, the PRA, can deal with prudential regulation and that conduct matters can be dealt with by the FCA.³¹³ This should enable the PRA to focus better on matters relating to risk. This means that there are a substantial number of employees dealing with prudential matters. It also means that the focus of these employees can be on prudential regulation. Previously, the FSA actually focused on consumer conduct matters and not prudential matters.³¹⁴ These structural changes should have some beneficial effects upon prudential regulation. Perhaps there has been too little discussion on the effect of changes in legislation that have had an effect upon risk evaluation by the regulator. The new objective of financial stability³¹⁵ is important for this reason. A regulator is likely to give additional attention to those banks that are of greater economic importance even if their risk profile does not justify it. Indeed, the too big to fail issue is likely to dictate this.³¹⁶ The consequences of a too big to fail bank actually failing may be so highly unpredictable that a regulator will simply not allow it to happen at almost any cost.³¹⁷ However, the introduction of legislation providing for deposit protection could encourage the regulator to pay less attention as depositors would be protected in a regulatory environment that can never provide complete protection.³¹⁸

3. Approach of the PRA after the abolition of the FSA -- new wine in new bottles

The PRA has wanted banking institutions to act in a responsible way. There have been criticisms made by Parliament that some banks took excessive risks in relation to their lending before the banking collapse. The PRA has issued a statement³¹⁹ about the need for a culture change on the part of banks. Firms are expected to act prudently. The problem with such an approach is that banks have increasingly become larger and larger entities keen on maximising their profits and paying little heed to the risks that this poses.

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This article is not the place to analyse the distinctions between principle and rule based regulation. This has been done elsewhere by others.³²⁰ The distinction may be less clear if the rules are "rounded off" and the principles "sharpened".³²¹ The rulebook has been described by one academic as "conspicuously principles based".³²² What is clear is that the PRA is to replace the six principles for business used by the FSA with nine fundamental principles.³²³ Rule 1,³²⁴ that a firm must conduct its affairs with integrity is very similar to the previous rule used by the FSA.³²⁵ Rule 2³²⁶ of the PRA, that a firm must act with due skill, care and diligence, is as the new rulebook states, simply a "shortened"³²⁷ version of the previous rule used by the FSA. There is however a "new"³²⁸ rule, fundamental rule 3 introduced by the PRA that the firms must act in a prudent manner. In mandatory language it provides that firms "must demonstrate sound judgement and exercise caution".³²⁹ Fundamental rule 4, the maintenance of adequate financial resources,³³⁰ is again similar to the previous principle of the FSA. The FSA had previously required firms to have adequate risk management systems and this is confirmed by fundamental rule 5³³¹ that firms must put in place risk management systems and also sound and effective strategies regarding risk. Further, firms must be able to demonstrate clear strategies for the identification of risks. The rule is there to deal with weaknesses of the risk management of banks that led to the financial crisis. Whether this upgrading of the rulebook is enough to stop some future crisis remains to be seen. There are further rules under the rulebook. Fundamental rule 6³³² requires firms to have proper internal governance and for that purpose it must organise and control its affairs effectively and responsibly. The FCA considers that in order to comply with this rule firms must have senior management and directors who are fit and proper to carry on the firm's business. The responsibilities of each must be clear as well as the apportionment of responsibilities between each. The subsequent fundamental rules, 7, 8 and 9 deal with matters other than the day-to-day management of firms and will not be considered.

The PRA has indicated³³³ that its approach to prudential regulation is that it now places "greater emphasis on certain criteria than was the case with the FSA".³³⁴ Further, when the PRA supervises firms, it supervises them in order to determine whether they are acting in a manner that is safe and sound.³³⁵ When assessing this the PRA has regard to the firm's potential impact upon the financial stability of the financial system.³³⁶ Furthermore, the PRA has indicated that it examines a firm's business model to determine if it could adversely affect other firms participating within the financial system.³³⁷ Thus, there is to be a substantive change, which needs to be separate from organisational changes and staff increases.³³⁸ Such changes are necessary and desirable. However, despite all these changes to prudential regulation above, the ARROW system relating to risk appears to still be firmly in place.³³⁹ The changes to the rules above are not insignificant but again it will be up to the PRA to effectively enforce them and carry out what it says it will do. The rules are not enough in themselves.

We had, at least in theory, a system of prudential regulation under the FSA and we continue to have a system of prudential regulation under the PRA. The rulebook requires banks to act in a prudent manner and for the PRA to be proactive in the ways mentioned above. If both play their part, and carry out the above duties, then the lessons of the recent financial crisis may finally have been learnt, particularly as regards proactive and effective prudential regulation. If not, then another catastrophe may yet strike again. Further, the PRA must be prepared to tackle multinational banks that do not adhere to its risk taking strategy³⁴⁰ and not be deterred from so doing by their size and economic power.

¹ This article will use various statements made to the various parliamentary committees which may include uncorrected transcripts. The copyright of their authors and Parliament is acknowledged. In some cases the witnesses have not had the opportunity to correct their statements.

² This immunity is contained in the Financial Services and Markets Act 2000 and has meant that the FSA cannot be sued for negligence.

³ J Gray, "Is It Time To Highlight the Limits of Risk-Based Financial Regulation (2009) 4(1) *Capital Markets Law* 50.

⁴ In particular, the *Telegraph* and the *Financial Times* have coverage about the Treasury Select Committee.

⁵ J Black, "Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037, in the section on meta-regulation.

⁶ J Black, "Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review*, 1037, in the section on meta-regulation.

⁷ A Kokkinis, "Rethinking Banking Prudential Regulation: Why Corporate Governance Rules Matter" (2012) 7 *Journal of Business Law* 611, 621.

⁸ For a discussion of the previous tripartite system and the lack of communication between the FSA and the Bank of England, see N Clayton, "Many Hands Make Light Work: The Tripartite Arrangement as Part of the Legislative Reforms to Banking Legislation in the UK -- a Spectrum of Views from a Spectrum of Institutions" (2010) 4 *Law and Financial Markets Review* 366.

⁹ J Black, "Paradoxes and Failures: 'New Governance' Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037.

¹⁰ F Akinbami, "Is Meta-Regulation All It's Cracked Up to Be? The Case of UK Financial Regulation" (2013) 14 *Journal of Banking Regulation* 16 in the section on meta-regulation and its features.

¹¹ J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512.

¹² See F Akinbami in his article "Is Meta-Regulation All It's Cracked Up to Be? The Case of UK Financial Regulation (2013) 14 *Journal of Banking Regulation* 16 towards the end of the section on problems associated with meta-regulation.

¹³ See F Akinbami, "Is Meta-Regulation All It's Cracked up to Be? The Case of UK Financial Regulation (2013) 14 *Journal of Banking Regulation* 16, who sees light touch regulation as an example of regulatory inertia, towards the end of the section on problems associated with meta-regulation.

¹⁴ Professor Julia Black considers that matters relating to risk can be seen as falling within meta-regulation. J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512, at 544, which she calls "inter-dependency" between risk and meta-regulation.

¹⁵ Professor Julia Black confirms that the regulator will be reliant upon the internal risk models of the firms' (banks') models, J Black, "Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority" (2006) 28(1) *Law and Policy* 1, 22.

¹⁶ S Gilad, "It Runs in the Family: Meta-Regulation and Its Siblings" (2010) 4 *Regulation and Governance* 485, 488.

¹⁷ D Singh and J LaBrosse, "Northern Rock, Depositors and Deposit Insurance Coverage: Some Critical Reflections" (2010) 2 *Journal of Business Law* 55, 59.

¹⁸ D Singh and J LaBrosse, "Northern Rock, Depositors and Deposit Insurance Coverage: Some Critical Reflections" (2010) 2 *Journal of Business Law* 55, 59. D Singh and J LaBrosse emphasize supervision and monitoring. This author adds enforcement to the above.

¹⁹ R Lastra and G Wood, "The Crisis of 2007-9: Nature, Causes, and Reactions" (2010) 13(3) *Journal of International Economic Law* 531, 539, dealing with failures at an international level, identify failures of regulation and supervision.

²⁰ See the discussion by Nigel Clayton on the Independent Commission on Banking Reform Interim Report and Final Report: N Clayton, "An Overview on the Inconsistencies of Approach in Regulating the Capital Position of Banks: Will the United Kingdom Step Out of Line with Europe?" (2013) 14(2) *Journal of Banking Regulation* 107. For an update of Basel III see E Lee, "Basel III: Post-Financial Crisis International Financial Regulatory Reform" (2013) 28(11) *Journal of International Banking Law and Regulation* 433.

²¹ See Clayton, *supra* n 8.

²² See Clayton, *supra* n 20.

²³ See generally HS Scott, "Reducing Systemic Risk through the Reform of Capital Regulation", in T Cottier, J Jackson and R Lastra (eds), *International Law and Financial Regulation and Monetary Affairs* (Oxford University Press, 2012), Chapter 12, 222-36.

²⁴ See Clayton, *supra* n 20.

²⁵ House of Commons Oral Evidence Taken before the Treasury Committee: Independent Commission on Banking, 24 May 2011, Sir John Vickers, Martin Taylor and Bill Winters. Neither witnesses nor members have had the opportunity to correct the record. The transcript is not yet an approved formal record of these proceedings.

²⁶ It has proposed the introduction of a ratio of 10% core tier one capital as against risk-weighted assets. See generally, N Clayton, "An Overview on the Inconsistencies of Approach in Regulating the Capital Position of Banks: Will the United Kingdom Step Out of line with Europe?" (2013) 14(2) *Journal of Banking Regulation* 107.

²⁷ P Jenkins, "Capital Warning from Bank Reformer: Buffers Should Be Doubled, Says Vickers", *Financial Times*, 9 September 2013.

²⁸ J Black, "Paradoxes and Failures: New Governance Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037 in the section on meta-regulation.

²⁹ J Black, "Paradoxes and Failures: New Governance Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037 in the section on meta-regulation.

³⁰ J Black, "Paradoxes and Failures: New Governance Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037 in the section on meta-regulation.

³¹ J Black, "Paradoxes and Failures: New Governance Techniques and the Financial Crisis" (2012) 75(6) *Modern Law Review* 1037 in the section on meta-regulation. See also, J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512, at 545, where she is of the view that this difference means that regulators cannot rely on the internal models of an organisation.

³² See A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda" (2010) 7 *Journal of Business Law* 599. See also, J Black, "Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulatory Authority" (2006) 28 *Law and Policy* 1, 22 in section A Risk-Based Regulation and Meta-Regulation.

³³ See section G on HBOS.

³⁴ See section G on HBOS and its collapse.

³⁵ See G Walker, "Financial Crisis -- UK Policy and Regulatory Response" (2010) 44(2) *The International Lawyer* 751, 759, where he deals with liquidity and capital issues. The Turner Review which also deals with these matters is considered subsequently though the macro-prudential aspects are outside the scope of this article which concentrates on prudential regulation.

³⁶ See in particular, section G on HBOS and its collapse.

³⁷ In particular, see section F on Northern Rock.

³⁸ See Scott, *supra* n 23.

³⁹ See Clayton, *supra* n 20.

⁴⁰ Evidence of Lord Turner in answer to question 1079 of Jesse Norman -- giving evidence before the Treasury Committee in relation to Libor and Barclays Bank: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume II: Oral and Written Evidence, HC 481-II, 18 August 2012), Ev92. This conversation is highlighted in the House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report together with Formal Minutes, HC 481-I, 18 August 2012), under the heading: "A New Approach by the FSA" at paragraph 150.

⁴¹ This will be referred to later on in this paper. In particular see the analysis of Professor Julia Black: J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512, where there is a detailed analysis of ARROW with empirical interview research.

⁴² This is pointed out by Professor Joanna Gray: "Is It Time to Highlight the Limits of Risk-Based Financial Regulation?" (2009) 4(1) *Capital Markets Law Journal* 50 at 58 in the section: Applicable ARROW Framework to FSA supervision of Northern Rock and its account of its discharge of its supervision, referring to the evidence of Hector Sants (of the FSA) responding to question 192 from the Treasury Select Committee -- Transcript of Evidence from the 9 October 2007 Treasury hearings.

⁴³ J Gray, "Is It Time to Highlight the Limits of Risk-Based Financial Regulation?" (2009) 4(1) *Capital Markets Law Journal* 50, in section 2, Northern Rock and the performance of risk-based regulation. A similar comment about the failure of the FSA in relation to Northern Rock and Bradford and Bingley is made in A Lui, "Macro and Micro Prudential Regulatory Failures between Banks in the United Kingdom and Australia 2004-2009" (2013) 21(3) *Journal of Financial Regulation and Compliance* 241, where Alison Lui writes at 242: "The financial crisis has exposed serious ... regulatory failures ...". See also further comment

about the FSA in relation to Northern Rock by Professor Emiliios Avgouleas where he writes that Parliament criticised both the Bank of England and the FSA but "clearly reserved its harshest criticism for the FSA ...": E Avgouleas, "Banking Supervision and the Special Resolution Regime of the Banking Act 2009: The Unfinished Reform" (2009) 4(2) *Capital Markets Law Journal* 201, in section 1: Introduction.

⁴⁴ E Ferran, "The Break-up of the Financial Services Authority" (2011) 31(3) *Oxford Journal of Legal Studies* 455, 461 in section 2 Did the FSA have to go?, where the author asks this as a rhetorical question. The question he asks is "Was the FSA beyond repair because of its failure to pay sufficient attention to prudential matters?"

⁴⁵ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008). This article will look at failings of the FSA and not the role of the Bank of England in its lending role. For this aspect see P Davies, "Liquidity Safety Nets for Banks" (2013) 13(2) *Journal of Corporate Law Studies* 287.

⁴⁶ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 3.

⁴⁷ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 24, paragraph 42.

⁴⁸ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at pages 25 and 26, paragraph 45.

⁴⁹ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 26, paragraph 47 quoting from the view of Professor Buiter that there was too much emphasis on capital matters and not enough on liquidity. However Parliament's conclusion at page 29, paragraph 52, having reviewed the evidence, does not explain why, at that point, the regulatory approach of the FSA was "flawed".

⁵⁰ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 32, paragraphs 57 and 59 in particular. The conclusion in paragraph 59 was that the FSA approach to stress testing proved to "have been thoroughly inadequate".

⁵¹ House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 32, paragraph 57 where the Parliamentary Committee highlights the view of Hector Sants (of the FSA). This extract is cited in J Gray, "Is It Time to Highlight the Limits of Risk- Based Financial Regulation?" (2009) 4(1) *Capital Markets Law Journal* 50, which she considered to be a robust approach on his part.

⁵² House of Commons Treasury Committee, *The Run on the Rock* (Fifth Report of Session 2007-08, HC 56-I, 26 January 2008) at page 34, paragraph 66.

⁵³ HBOS is discussed below and the failure of the FSA to specifically stress test liquidity scenarios is discussed in relation to HBOS. See the Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II) in section 9 Regulatory and Supervisory approach.

⁵⁴ Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II) in section 9 Regulatory and Supervisory approach.

⁵⁵ FSA Internal Audit Division, "The Supervision of Northern Rock: A Lessons Learned Review" (Report March 2008), http://www.fsa.gov.uk/pubs/other/nr_report.pdf, accessed on 23 June 2015.

⁵⁶ See paragraph 22 of the FSA report.

⁵⁷ See B5 Emerging business risks: 5.5 Conclusions from emerging business risks: paragraph 18 of the FSA report.

⁵⁸ See paragraph 23 of the FSA report.

- ⁵⁹ See B7 Capital, liquidity and stress testing: impact on FSA: paragraph 4 of the FSA report.
- ⁶⁰ See B7 Capital, liquidity and stress testing: impact on FSA: paragraph 7 (Conclusion) of the FSA report.
- ⁶¹ See B7 Capital, liquidity and stress testing: impact on FSA: 7.8 Stress testing: paragraph 52 of the FSA report.
- ⁶² N Clayton, "An Overview on the Inconsistencies of Approach in Regulating the Capital Position of Banks: Will the United Kingdom Step Out of Line with Europe?" (2013) 14(2) *Journal of Banking Regulation* 107. As is pointed out by the FSA report too much attention was being paid by regulators about capital matters and not enough about liquidity matters. This deficiency is demonstrated in relation to Basel III which concentrated upon capital of banks.
- ⁶³ See paragraph 24 of the FSA report.
- ⁶⁴ See B2 ARROW assessment: paragraph 7 of the FSA report.
- ⁶⁵ Page 19: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011.
- ⁶⁶ "FSA's report into HBOS" (1 March 2013 Terms of Reference HBOS review pdf), <http://www.parliament.uk/business/committees/committees-a-z/commons-select>, accessed on 23 June 2015.
- ⁶⁷ "FSA's report into HBOS" (1 March 2013 Terms of Reference HBOS review pdf), <http://www.parliament.uk/business/committees/committees-a-z/commons-select>, accessed on 23 June 2015.
- ⁶⁸ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 608, where he writes "the Turner Review concludes that the FSA relied too much on the exercise of discretion of the firms' senior managers, it was not aggressive enough in demanding adjustments of business models".
- ⁶⁹ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, at 606, commenting upon Northern Rock. See also N Clayton, "Many Hands Make Light Work: The Tripartite Arrangement as Part of the Legislative Reforms to Banking Legislation in the UK -- a Spectrum of Views from a Spectrum of Institutions" (2010) 4 *Law and Financial Markets Review* 366, 371-72, dealing with Northern Rock.
- ⁷⁰ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 606.
- ⁷¹ House of Lords, House of Commons, Parliamentary Commission on Banking Standards, "*An Accident Waiting to Happen*": *The Failure of HBOS* (Fourth Report of Session 2012-13, Volume I: Report and Volume II: Oral and Written Evidence, HL Paper 144 and HC 705, 4 April 2013).
- ⁷² See paragraph 72: "*An Accident Waiting to Happen*", *supra* n 71.
- ⁷³ See paragraph 77: "*An Accident Waiting to Happen*", *supra* n 71.
- ⁷⁴ See paragraph 76: "*An Accident Waiting to Happen*", *supra* n 71. See the points made in earlier in section E on bank capital and stress testing, about the incorrect focus of the FSA upon capital and the expense of a focus upon liquidity.
- ⁷⁵ See paragraph 83: "*An Accident Waiting to Happen*", *supra* n 71.
- ⁷⁶ See paragraph 86: "*An Accident Waiting to Happen*", *supra* n 71.
- ⁷⁷ See section E on bank capital and stress testing.

⁷⁸ See paragraph 85: "*An Accident Waiting to Happen*", *supra* n 71.

⁷⁹ See section E on bank capital and stress testing.

⁸⁰ "*An Accident Waiting to Happen*", *supra* n 71.

⁸¹ Quoted from paragraph 85: "*An Accident Waiting to Happen*", *supra* n 71, in the section Conclusions.

⁸² J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512.

⁸³ J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512, at 539.

⁸⁴ J Black, "The Emergence of Risk-Based Regulation and the New Public Risk Management in the United Kingdom" (2005) *Public Law* 512, at 539.

⁸⁵ Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II), section 9 Regulatory and Supervisory approach paragraph 927, summarising the views of Andrew Bailey.

⁸⁶ Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II), section 9 Regulatory and Supervisory approach paragraph 926, quoting from the evidence of Peter Cummings.

⁸⁷ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (27 February 2013, HC 606-xxxix) in response to Q4419 Mr Love that statements had been made by Howard Davies, at the time when the FSA was created, that the FSA would take a risk based approach as opposed to a box ticking approach.

⁸⁸ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i), Sub-Committee B -- Panel on HBOS: page 1 Introduction by Lord Turnbull.

⁸⁹ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i), Sub-Committee B -- Panel on HBOS in response to Q23 David Quest.

⁹⁰ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i), Sub-Committee B -- Panel on HBOS: response "Yes" to the statement of Lord Turnbull Q85 (B Ev 10).

⁹¹ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i), Sub-Committee B -- Panel on HBOS: answer by Colin Matthew to Q127 of Lord Turnbull.

⁹² House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i), Sub-Committee B -- Panel on HBOS.

⁹³ Answer by Jo Dawson to Q263 David Quest.

⁹⁴ House of Commons, House of Lords Oral, Evidence Taken before the Parliamentary Commission on Banking Standards (30 October 2012, HC 705-i) Sub-Committee B -- Panel on HBOS: page 1 Introduction by Lord Turnbull. The counsel was David Quest.

⁹⁵ House of Commons, Page 1 Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS on 12 November 2012: referred to as Panel on HBOS 12 November 2012: questions 277-516.

- ⁹⁶ See the Panel on HBOS 12 November 2012, at page 1.
- ⁹⁷ View of Mike Ellis in response to question 298 of David Quest: Panel on HBOS 12 November 2012 page 6.
- ⁹⁸ View of Mike Ellis in response to question 337 of Andrew Tyrie: Panel on HBOS 12 November 2012 page 12.
- ⁹⁹ View of Phil Hodgkinson in response to question 390 David Quest: Panel on HBOS 12 November 2012 page 23.
- ¹⁰⁰ View of Phil Hodgkinson in response to question 424 David Quest: Panel on HBOS 12 November 2012 page 31, and question 441 David Quest page 35.
- ¹⁰¹ View of Phil Hodgkinson in response to question 441 David Quest: Panel on HBOS 12 November 2012 page 35.
- ¹⁰² House of Commons, Page 1 Oral Evidence Taken before the Parliamentary Commission on Banking Standards -- Banking Standards (3 December 2012): questions 1226-1526 in response to question 1277 of Rory Phillips QC.
- ¹⁰³ House of Commons, Page 1 Oral Evidence Taken before the Parliamentary Commission on Banking Standards -- Banking Standards (3 December 2012), questions 1226-1526: in response to question 1478 of Lord Turnbull.
- ¹⁰⁴ House of Commons, Page 19 Oral Evidence Taken before the Parliamentary Commission on Banking Standards -- Banking Standards (3 December 2012), Q1329. The quote is taken from the quote from the questioner Lord Turnbull.
- ¹⁰⁵ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (16 November 2012, HC 705-iii), Response of George Mitchell to Q696 by Lord Turnbull.
- ¹⁰⁶ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (16 November 2012, HC 705-iii), Q697 Lord Turnbull which is in the form of a comment.
- ¹⁰⁷ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (16 November 2012, HC 705-iii), response of witness George Mitchell to the Q697 of Lord Turnbull above.
- ¹⁰⁸ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012, HC 705-viii), Q1374 (Introduction) by Lord Turnbull.
- ¹⁰⁹ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012, HC 705-viii), questions 1374-1508. Q1402 from David Quest: "What did the FSA do to address that issue?" (HBOS's increasing demand for wholesale funding).
- ¹¹⁰ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012), questions 1374-1508. Question 1402 from David Quest: "What did the FSA do to address that issue?" (HBOS's increasing demand for wholesale funding).
- ¹¹¹ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012), questions 1374-1508: in response to question 1408: David Quest.
- ¹¹² House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012), questions 1374-1508: in response to question 1421: David Quest.
- ¹¹³ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012), questions 1374-1508: the view of Lord Turnbull as set out in his question 1500.

¹¹⁴ House of Commons, House of Lords, Oral Evidence Taken before the Parliamentary Commission on Banking Standards Sub-Committee B -- Panel on HBOS (30 November 2012), questions 1374-1508: in response to question 1500 of the chairperson Lord Turnbull.

¹¹⁵ The reforms to the PRA are considered at the end of this article.

¹¹⁶ See below. See part 2 of this section.

¹¹⁷ FSA's report into HBOS (1 March 2013), <http://www.parliament.uk/search/results>, accessed on 23 June 2015.

¹¹⁸ FSA's report into HBOS (1 March 2013) -- Terms of Reference HBOS review pdf, <http://www.parliament.uk/search/results>, accessed on 23 June 2015.

¹¹⁹ See *supra* n 5.

¹²⁰ The Turner Review and Lord Turner's acceptance of criticism are discussed below. See on this J Gray, "What Next for Risk-Based Financial Regulation?", Chapter 8 in I MacNeil and J O'Brien (eds), *The Future of Financial Regulation* (Oxford, Hart Publishing, 2010). See also, A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 607-10.

¹²¹ See in particular, the literature in the footnote above.

¹²² It is to be hoped that the HBOS Review: A report by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) into the failure of HBOS plc (forthcoming) will explain this.

¹²³ I MacNeil, "Editorial" (2011) 5(3) *Law and Financial Markets Review* 161.

¹²⁴ See N Clayton, "An Overview on the Inconsistencies of Approach in Regulating the Capital Position of banks: Will the United Kingdom Step Out of Line with Europe?" (2013) 14(2) *Journal of Banking Regulation* 107, where this author makes the point that there are in place requirements for greater capital for systemically important banks.

¹²⁵ Detailed Terms of Reference for the HBOS Review <https://www.fca.org.uk/static/documents/hbos-review-terms-of-reference.pdf> (September 2012), accessed on 23 June 2015.

¹²⁶ *Supra* n 125. The collapse of RBS is discussed below in section H.

¹²⁷ This has been discussed previously in section F.

¹²⁸ This will be discussed subsequently in section H.

¹²⁹ Enforcement proceedings and in particular in relation to RBS are considered below in section H.

¹³⁰ House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, Report together with formal minutes, oral and written evidence, HC 640, 19 October 2012).

¹³¹ Page 15: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015 -- "he [Andrew Tyrie MP, Chairman of the Treasury Select Committee] proposed that the FSA should produce a more comprehensive report into the causes of RBR's failure, and should identify and report on any key deficiencies in the FSA's own regulation and supervision of RBS in the years running up to failure".

¹³² Page 10: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015.

¹³³ Page 10: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015.

¹³⁴ Page 10: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015.

¹³⁵ Page 11: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015.

¹³⁶ Page 22: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "deficient regulation".

¹³⁷ Page 23, paragraph 9: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "deficient regulation".

¹³⁸ Page 23, paragraph 11: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "RBS's liquidity position".

¹³⁹ Page 23, paragraph 11: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "RBS's liquidity position".

¹⁴⁰ Page 24, paragraphs 13 and 14: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "Asset quality: concerns and uncertainties".

¹⁴¹ Page 27, paragraph 28: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on "The FSA's overall approach to supervision: priorities, processes and resources".

¹⁴² RBS was the head of a consortium.

¹⁴³ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁴ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁵ Page 25, paragraph 19: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁶ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁷ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁸ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁴⁹ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁵⁰ Page 25, paragraph 20: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section on The ABN AMRO acquisition: an extremely risky deal.

¹⁵¹ Page 76, paragraph 44: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section 1 factors contributing to RBS's failure: 1.1 RBS capital position.

¹⁵² Page 82, paragraph 67: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 in the section 1 factors contributing to RBS's failure: 1.1 RBS capital position.

¹⁵³ Page 95, paragraph 113: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.2 RBS liquidity position.

¹⁵⁴ Page 104, paragraph 149: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.2 RBS liquidity position and reiterating the similar point made by the FSA about itself in the internal report about Northern Rock: The NR Report Section 3.2 paragraphs 2-3 March 2008, *supra* n 55.

¹⁵⁵ Page 106, paragraph 154: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.2 RBS liquidity position.

¹⁵⁶ Page 108, paragraphs 161 and 162: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in section 1.2 RBS liquidity position.

¹⁵⁷ Page 109/110, paragraphs 164 and 170: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.2 RBS liquidity position.

¹⁵⁸ Pages 110/116, paragraphs 172 and 198: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.2 RBS liquidity position.

¹⁵⁹ Page 136, paragraph 255: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.3 Asset-quality.

¹⁶⁰ Page 136, paragraph 255: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.3 Asset-quality.

¹⁶¹ Page 135, paragraph 251: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.3 Asset-quality.

¹⁶² Page 139, paragraph 263: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS's failure: 1.3 Asset-quality.

¹⁶³ Page 139, paragraph 263: The Failure of the Royal Bank of Scotland: FSA Board Report 2011 in the section 1 factors contributing to RBS failure 1.3 Asset-quality.

¹⁶⁴ Page 153, paragraph 311: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁶⁵ Pages 153 and 154, paragraph 313: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁶⁶ Page 153, paragraph 311 and see the general discussion at paragraphs 315-317: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁶⁷ Page 153, paragraph 311: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁶⁸ Page 155, paragraph 318: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁶⁹ Page 155, paragraph 320: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁷⁰ Page 157, paragraph 322: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.4 Losses in credit trading activities.

¹⁷¹ Page 161, paragraph 330: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷² Page 180, paragraph 420: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷³ Page 180, paragraph 420: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷⁴ Page 186, Conclusions on the FSA's regulation and supervision: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷⁵ Page 181, paragraph 422: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷⁶ Page 183, paragraph 433: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition where the internal records of the FSA for October 2007 are referred to.

¹⁷⁷ Page 183, paragraph 433: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition where the internal records of the FSA for October 2007 are referred to.

¹⁷⁸ Page 184, paragraph 438: The Failure of the Royal Bank of Scotland: FSA Board Report in the section 1 factors contributing to RBS's failure: 1.5 ABN AMRO acquisition.

¹⁷⁹ Where the Turner Review deals with macro-regulation, this is outside the scope of this article with its concentration upon prudential regulation.

¹⁸⁰ Page 116, paragraph 199: The Failure of the Royal Bank of Scotland: FSA Board Report in section 1.2 RBS's liquidity position.

¹⁸¹ Page 116, paragraph 199: The Failure of the Royal Bank of Scotland: FSA Board Report in section 1.2 RBS's liquidity position.

¹⁸² Page 239, paragraph 199: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Management governance and culture.

¹⁸³ Page 239, paragraph 199: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Management governance and culture.

¹⁸⁴ Page 258, paragraph 680: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Supervisory approach, priorities and resources.

¹⁸⁵ Page 258, paragraph 680: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Supervisory approach, priorities and resources.

¹⁸⁶ Pages 260 and 261, paragraph 686: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Supervisory approach, priorities and resources. A selection of these failings where the FSA over concentrated on consumer matters is discussed by N Clayton, "Many Hands Make Light Work: The Tripartite Arrangement as Part of the Legislative Reforms to Banking Legislation in the UK -- a Spectrum of Views from a Spectrum of Institutions" (2010) 4 *Law and Financial Markets Review* 366, at 370 where Lord Turner confirms the incorrect approach on processes and structures by the FSA which failed to concentrate upon the risk models of the firms.

¹⁸⁷ Page 264, paragraph 692: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Management governance and culture.

¹⁸⁸ Page 264, paragraph 691: The Failure of the Royal Bank of Scotland: FSA Board Report in section 3 Management governance and culture.

¹⁸⁹ Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II, June 2013) in section 9 Regulatory and supervisory approach: Regulatory failure, paragraph 916.

¹⁹⁰ Parliamentary Commission Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14, Volume II: HL Paper 27-II and HC 175-II, June 2013) in section 9 Regulatory and supervisory approach: Regulatory failure, paragraph 917.

¹⁹¹ Parliamentary Commission on Banking Standards, *Changing Banking for Good* (First Report of Session 2013-14 Volume II: HL Paper 27-II and HC 175-II, June 2013), section 9 Regulatory and supervisory approach: Regulatory failure, paragraph 915.

¹⁹² The Financial Services Authority, The Failure of the Royal Bank of Scotland: FSA Board Report, December 2011.

¹⁹³ Paragraph 14: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

¹⁹⁴ Paragraph 22: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

¹⁹⁵ Paragraph 31: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

¹⁹⁶ Paragraph 31: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012). See above paragraph 198 where Hector Sants gives evidence to the House of Commons Treasury Committee: Independent Review of the Financial Services Authority's Report on the Failure of the Royal Bank of Scotland (30 January 2012, HC 1780-ii).

¹⁹⁷ Paragraph 32: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

¹⁹⁸ Paragraph 33: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

¹⁹⁹ Page 12: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011 available at <http://www.fsa.gov.uk/static/pubs/other/rbs.pdf>, accessed on 23 June 2015.

²⁰⁰ The Failure of the Royal Bank of Scotland: FSA Board Report December 2011. Changes to regulation and supervisory approach already made, and further recommendations page 29 at paragraph 38.

²⁰¹ Paragraph 29: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012).

²⁰² Paragraph 43: House of Commons Treasury Committee, *The FSA's Report into the Failure of RBS* (Fifth Report of Session 2012-13, HC 640, 19 October 2012), where the Treasury Committee stated that it agreed with the view and conclusion of Sir David Walker.

²⁰³ Independent Review of the Financial Services Authority's Report on the Failure of the Royal Bank of Scotland 30 January 2012 Uncorrected Transcript of Oral Evidence HC 1780-ii House of Commons Oral Evidence Question 117 of Mr McFadden. This point is also made at page 12 in *The Failure of the Royal Bank of Scotland: FSA Board Report*: "the FSA did not formally consider whether the risks in the ABN AMRO acquisition were acceptable, because RBS did not have to seek the FSA's regulatory approval for the contested takeover of ABN AMRO ...".

²⁰⁴ Independent Review of the Financial Services Authority's Report on the Failure of the Royal Bank of Scotland 30 January 2012 Uncorrected Transcript of Oral Evidence HC 1780-ii House of Commons Oral Evidence Question 118 of Mr McFadden, who indicated that he thought the FSA did have power to intervene. The question was "But you did have the power to intervene, didn't you?".

²⁰⁵ See Sir David Walker's view upon this matter in n 195.

²⁰⁶ Independent Review of the Financial Services Authority's Report on the Failure of the Royal Bank of Scotland 30 January 2012 Uncorrected Transcript of Oral Evidence HC 1780-ii House of Commons Oral Evidence Questions 88-191.

²⁰⁷ In this regard appeals go before an upper tribunal. Independent Review of the Financial Services Report on the Failure of the Royal Bank of Scotland 30 January 2012 Uncorrected Transcript of Oral Evidence HC 1780-ii House of Commons Oral Evidence Question 97 of Mr Ruffley put specifically to Lord Turner. See also, pages 7 and 8: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011* where the FSA explains that it did not have power(s) to take enforcement action.

²⁰⁸ *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement*.

²⁰⁹ Page 349, paragraph 4: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement*.

²¹⁰ Page 350, paragraph 9: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations*.

²¹¹ Page 352, paragraph 16: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations*.

²¹² Page 354, paragraph 25: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations*.

²¹³ Page 354, paragraph 25: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations*.

²¹⁴ Page 407, paragraph 196: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO*.

²¹⁵ Page 408, paragraph 198: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO*.

²¹⁶ Page 412, paragraph 218: *The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO*.

²¹⁷ Page 415, paragraph 230: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3; 2: The acquisition of ABN AMRO.

²¹⁸ Page 418, paragraph 243: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3:2: The acquisition of ABN AMRO.

²¹⁹ Page 418, paragraph 247: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO.

²²⁰ Page 418, paragraph 247: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3:2: The acquisition of ABN AMRO.

²²¹ Page 418, paragraph 247: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO. See also page 422, paragraph 257: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABM AMRO.

²²² Page 419, paragraph 247: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO.

²²³ Page 419, paragraph 247: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3: 2: The acquisition of ABN AMRO.

²²⁴ Page 356, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²²⁵ Page 357, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²²⁶ Page 357, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²²⁷ Page 357, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011. Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²²⁸ Page 357, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²²⁹ Page 357, paragraph 31: The Failure of the Royal Bank of Scotland: FSA Board Report December 2011: Part 3 FSA Enforcement: Scope of Enforcement Division's investigations.

²³⁰ This article is not about enforcement actions.

²³¹ R Falkner, "FSA Disciplinary Enforcement Action against Senior Managers" (2012) 9 *Journal of International Banking and Financial Law* 576, where the author cites just one enforcement action at footnote 3.

²³² See H Schooner, "Private Enforcement of Systemic Risk Regulation" (2010) 43 *Creighton Law Review* 993.

²³³ S Thomas and H Edwards, "Is It Time for Firms to Reconsider Their Approach to Settling Enforcement Action?" (2013) 7(6) *Law and Financial Markets Review* 301.

²³⁴ *Hobbs v FCA* [2013] All ER (D) 365 finding that a trader was not fit and proper; *Burns v FCA* [2013] Lexis Citation 34: allegation of lack of integrity to be published. *Jeffrey v FCA* [2013] Lexis Citation 49: limitation defence raised in relation to prohibition order.

²³⁵ [2012] Lexis Citation 75.

²³⁶ D McCluskey and N Queree, "The Buck Stops Where? Regulatory Action against Senior Managers post *FSA v John Pottage*" (2012) 8 *Journal of International Banking and Financial Law* 490.

²³⁷ Detailed Terms of Reference for the HBOS Review, paragraph 4(f), *supra* n 125.

²³⁸ Andrew Green QC, *supra* n 125.

²³⁹ Detailed Terms of Reference for the HBOS Review, paragraph 4(f), *supra* n 125.

²⁴⁰ House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, 18 August 2012).

²⁴¹ Paragraph 7: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012).

²⁴² Paragraph 7: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012).

²⁴³ Paragraph 64: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012).

²⁴⁴ Paragraph 64: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012).

²⁴⁵ The wider aspects of the Libor investigation beyond the functioning of the FSA are outside the scope of this article.

²⁴⁶ Paragraph 58: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012), under the heading Barclays' contact with the regulators.

²⁴⁷ Paragraph 58: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report together with formal minutes, HC 481-I, August 2012), under the heading Barclays' contact with the regulators.

²⁴⁸ Paragraph 58: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012), under the heading Barclays' contact with the regulators.

²⁴⁹ Paragraph 58: House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume I: Report, together with formal minutes, HC 481-I, August 2012), under the heading Barclays' contact with the regulators. The full answer of Lord Turner in relation to Q1129 of Michael Fallon is contained in House of Commons Treasury Committee, *Fixing LIBOR: Some Preliminary Findings* (Second Report of Session 2012-13, Volume II: Oral and Written evidence HC 81-11) at Ev99.

²⁵⁰ Small groups of individuals, socially connected with high levels of trust placed in them internally are the factors are identified by Professor Julia Black as those which enable market manipulation: "Reconceiving Financial Markets -- From the Economic to the Social" (2013) 13 *Journal of Corporate Law Studies* 401, 425.

²⁵¹ P Jenkins, "The Forex Market's Design Is an Invitation to Crime", FT Comment, *Financial Times*, 7 November 2013, 13.

²⁵² "Bank of England to Restructure Following Claims of Forex Rigging", BBC News/Business 26523995.

²⁵³ *The Turner Review: A Regulatory Response to the Global Banking Crisis* (March 2009), available FSA website.

²⁵⁴ In particular A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599 at 607-14. See also, J Gray, "What Next for Risk-based Financial Regulation?", Chapter 8 in I MacNeil and J O'Brien (eds), *The Future of Financial Regulation* (Oxford, Hart Publishing, 2010), section D, D1: Turner and Flaws in Risk Modelling and D2: Did Turner Miss a Valuable Opportunity to Help Develop a New "Politics of Uncertainty".

²⁵⁵ See page 87 of the Turner Review.

²⁵⁶ See page 87 of the Turner Review.

²⁵⁷ See page 87 of the Turner Review.

²⁵⁸ Discussed previously in section G.

²⁵⁹ This review is currently taking place. See above at the end of the section on HBOS, *supra* n 125.

²⁶⁰ Currently taking place.

²⁶¹ Note 4 of the detailed Terms of Reference for the HBOS Review, *supra* n 125.

²⁶² R Baldwin and J Black, "Really Responsive Regulation" (2008) 71 *Modern Law Review* 59. Their article does not however focus on banking or financial regulation.

²⁶³ P Hampton, *Reducing Administrative Burdens: Effective Inspection and Enforcement* (HM Treasury, 2005), www.hm-treasury.gov.uk/Hampton, accessed on 23 June 2015. The FSA was specifically identified as a regulator, see paragraphs 1.15 and 1.22.

²⁶⁴ See paragraph 2.14 of the Hampton Review.

²⁶⁵ R Baldwin and J Black, "Really Responsive Regulation" (2008) 71 *Modern Law Review* 59.

²⁶⁶ See E Avgouleas, *Governance of Global Financial Markets: The Law, the Economics, the Politics* (Cambridge University Press, 2012), page 74, paragraph 6.2 "The Global Financial Crisis", where the report is mentioned at footnote 184.

²⁶⁷ The failures of other US banks, dealt with in the report are considered below. The collapse of New Century Financial Corporation will not be considered as it was not subject to federal or state regulation, see page 236 of the report. With Freemont Investment and Loan, considered at the end of the report, in section IV on regulatory failure, at pages 237 to 239, the FDIC did take action in March 2007 through a cease and desist order.

²⁶⁸ Page 161 of the report: United States Senate Permanent Sub Committee on Investigations, Committee on Homeland Security and Governmental Affairs (Carl Levin Chairman and Tom Coburn, Ranking Minority Member), *Wall Street and the Financial Crisis: Anatomy of a Financial Collapse Majority And Minority Staff Report Permanent Sub Committee on Investigations* (United States Senate, 13 April 2011) (referred to as the report in the footnotes below).

²⁶⁹ Page 165B of the report: Background.

²⁷⁰ Page 165B of the report: Background.

271 Page 161 of the report.

272 Page 161 of the report.

273 The account below is based upon the report and information contained in it, and is, in effect, a summary of it, with focus upon matters relevant to this article.

274 Page 162 of the report.

275 Page 162 of the report. See also page 163 of the report, where the Sub-Committee issued a statement confirming this opinion/conclusion. See also page 165 of the report, paragraph 8: Failure to recognise systemic risk.

276 Page 164 of the report, paragraph 5: Impeding FDIC oversight.

277 Page 164 of the report, paragraph 6: FDIC Shortfalls.

278 Page 166 of the report: (2) Federal Deposit Insurance Corporation.

279 Page 167 of the report: (3) Examination Process.

280 Page 167 of the report.

281 Page 168 of the report.

282 Page 171 of the report.

283 Page 173 of the report.

284 Page 173 of the report.

285 Page 199 of the report.

286 Pages 183, 184, 185, 186, 187, 188, 189, 190,194, 208, 209 of the report.

287 Page 195 of the report: Evidence taken from 16 April 2010 Sub- Committee hearing at page 18.

288 Page 209.

289 Page 221 of the report.

290 Pages 224, 225 and 226 of the report.

291 Pages 231 and 232 of the report.

292 Page 232 of the report.

293 Page 234 of the report.

²⁹⁴ Page 234 of the report.

²⁹⁵ Page 234 of the report. This emerged from an independent report of the Inspector General.

²⁹⁶ Page 234 of the report and footnote 906 of the report.

²⁹⁷ Page 234 of the report.

²⁹⁸ Page 235 of the report.

²⁹⁹ Page 161 of the report.

³⁰⁰ Page 240 of the report.

³⁰¹ For a comparison between UK and US regulatory enforcement before 2007, see D Singh, *Banking Regulation of UK and US Financial Markets* (Aldershot, Ashgate, 2007), Chapter 4, "Enforcement Powers and Banking Supervision", 113-51.

³⁰² G Nicholson and M Salib, "The Regulatory Powers and Purview of the Bank of England: Pre-and Post Crisis" (2013) 10 *Journal of International Banking and Financial Law* 636, 639 where the authors make the point that: "one of the criticisms of the statutory regime in relation to the FSA was that it was designed with a securities and conduct regulator in mind; it was not well-adapted for prudential regulation".

³⁰³ GAO-09-499T.

³⁰⁴ Pages 4, 17, GAO-09-499T.

³⁰⁵ Page 19, GAO-09-499T.

³⁰⁶ Pages 18, GAO-09-499T.

³⁰⁷ Page 18, GAO-09-499T.

³⁰⁸ Page 20, GAO-09-499T.

³⁰⁹ Page 23, GAO-09-499T.

³¹⁰ J Black, "Rebuilding the Credibility of Markets and Regulators" (2009) 3(1) *Law and Financial Markets Review* 1, 2.

³¹¹ J Black, "Rebuilding the Credibility of Markets and Regulators" (2009) 3(1) *Law and Financial Markets Review* 1, 2.

³¹² J Black, "Rebuilding the Credibility of Markets and Regulators" (2009) 3(1) *Law and Financial Markets Review* 1, 2.

³¹³ See generally E Ferran, "The Break-up of the Financial Services Authority" (2011) 31 *Oxford Journal of Legal Studies* 455.

³¹⁴ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 608, noting the acceptance of this in the Turner Review. Numerous examples of this focus are given in N Clayton, "Many Hands Make Light Work: The Tripartite Arrangement as Part of the Legislative Reforms to Banking Legislation in the UK -- a Spectrum of Views from a Spectrum of Institutions (2010) 4 *Law and Financial Markets Review* 366, 369, 370.

³¹⁵ J LaBrosse, "Time to Fix the Plumbing: Improving the UK Framework Following the Collapse of Northern Rock" (2008) 9(4) *Journal of Banking Regulation* 293, 299 makes the point that in order to have effective financial stability there needs to be a proper system of regulation that is supervised and monitored. See also, I MacNeil, "Editorial" (2012) 6(4) *Law and Financial Markets Review* 247.

³¹⁶ A point emphasised by Professor Julia Black: J Black, "Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority" (2006) 28(1) *Law and Policy* 1, 24 and 25.

³¹⁷ H McVea, "The Financial Services Compensation Scheme and Deposit Insurance Reform" (2008) *Lloyds Maritime and Commercial Law Quarterly* 389, 396.

³¹⁸ The inability of a prudential regulator to provide complete protection is emphasised by Professor Julia Black: J Black, "Managing Regulatory Risks and Defining the Parameters of Blame: A Focus on the Australian Prudential Regulation Authority" (2006) 28(1) *Law and Policy* 1, 25.

³¹⁹ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014) at page 20.

³²⁰ J Black, "Forms and Paradoxes of Principles-Based Regulation" (2008) 3(4) *Capital Markets Law Journal* 425, and also, J Black, M Hopper and C Band, "Making a Success of Principles-Based Regulation" (2007) 1(3) *Law and Financial Markets Review* 191.

³²¹ J Black, "Forms and Paradoxes of Principles-Based Regulation" (2008) 3(4) *Capital Markets Law Journal* 425, 434 where she cites the terminology from F Schauer, "The Tyranny of Choice and the Rulification of Standards" (2005) 14 *Journal of Contemporary Legal Issues* 803.

³²² A Georgosouli, "The Nature of the FSA Policy of Rule Use: A Critical Overview" (2008) 28(1) *Legal Studies* 119, 125.

³²³ See the PRA Rulebook June 2014 Policy Statement PS5/14, page 5, available at the Bank of England website.

³²⁴ See the PRA Rulebook June 2014 Policy Statement PS5/14, page 6, available at the Bank of England website.

³²⁵ The PRA's Fundamental Rules are set out in Box 2: The PRA's Fundamental Rules: *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), page 11. See The PRA Rulebook June 2014 Policy Statement PS5/14, 2.9 at page 6 available at the Bank of England website.

³²⁶ See the PRA Rulebook June 2014 Policy Statement PS5/14, 2.9 at page 6 available at the Bank of England website.

³²⁷ See the PRA Rulebook January 2014, page 6, 3.14 available Bank of England website.

³²⁸ See the PRA Rulebook June 2014 Policy Statement PS5/14, 2.10 at page 6 available at the Bank of England website.

³²⁹ See the PRA Rulebook January 2014, pages 6, 3.17 available Bank of England website.

³³⁰ See the PRA Rulebook January 2014, pages 6, 3.19 available Bank of England website.

³³¹ See the PRA Rulebook January 2014, pages 6, 3.21 available Bank of England website.

³³² See the PRA Rulebook January 2014, pages 6 and 7, 3.24-3.25.

³³³ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), page 13.

³³⁴ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), paragraph 36, at page 13.

³³⁵ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), paragraph 37, at page 13. Such an approach of supervision is consistent with the approach of L Garicano and R Lastra, "Towards a New Architecture for Financial Stability: Seven Principles" (2010) 13(3) *Journal of International Economic Law* 597, 618, where principle six is that [the regulator] "must limit its reliance on self-regulation".

³³⁶ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), paragraph 49 at page 16.

³³⁷ See *The Prudential Regulation Authority's Approach to Banking Supervision* (June 2014), paragraph 57 at page 17.

³³⁸ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 613.

³³⁹ A Georgosouli, "The Revision of the FSA's Approach to Regulation: An Incomplete Agenda?" (2010) 7 *Journal of Business Law* 599, 613.

³⁴⁰ Outlined above -- the fundamental principles in the PRA Rulebook.